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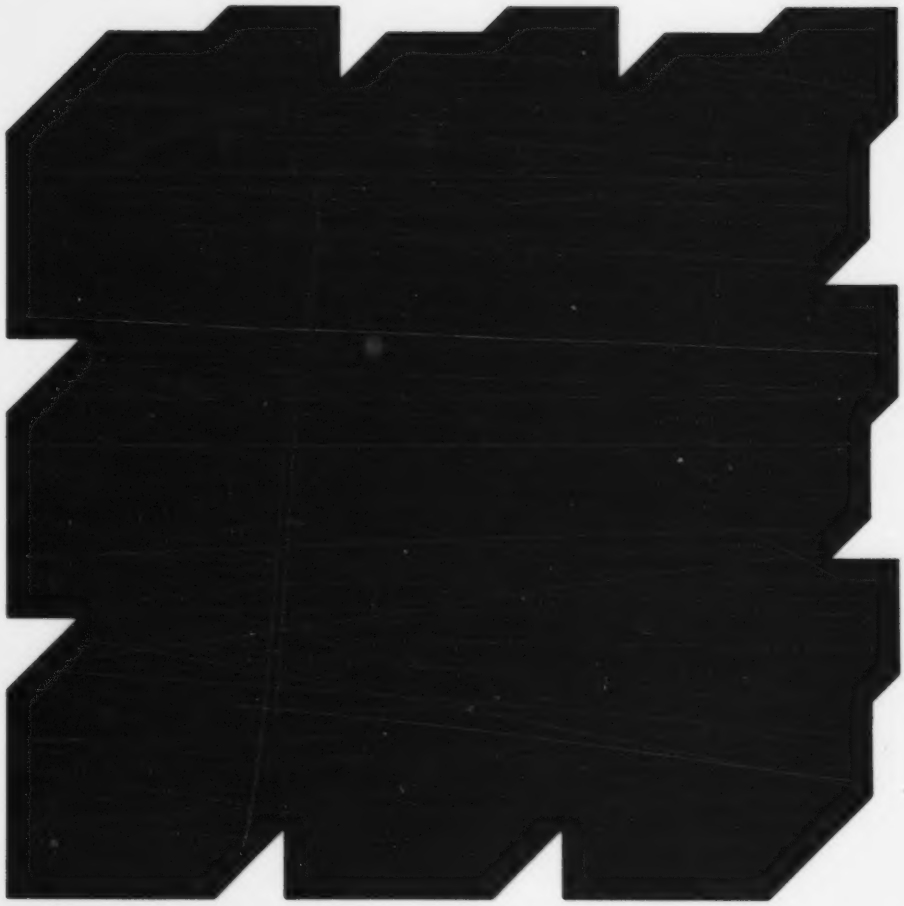

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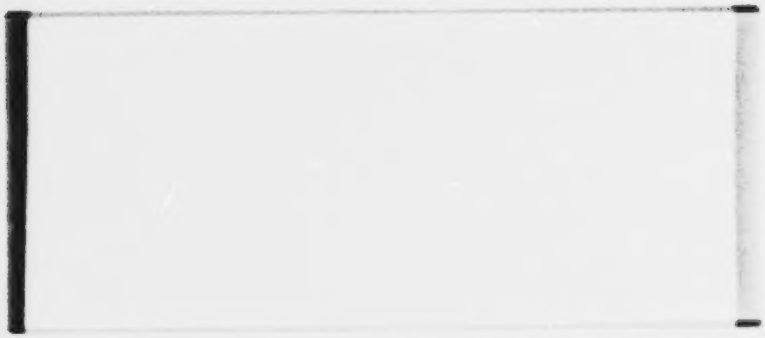

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DISCUSSION PAPER NO. 310

Current Financial Difficulties in Canadian Agriculture

by

Pierre Cloutier and
David MacMillan

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ABSTRACT

This report presents a review of the current financial situation in Canadian agriculture. It is an attempt to assess the gravity of the financial difficulties in the agricultural sector as a whole and in particular for those farmers with the heaviest debt burden.

To do this, the authors have reviewed recent research, consulted representatives of farm groups and private and public financial institutions, examined the conclusions and recommendations of other studies. Financial indicators, such as the rate of growth of income from ownership, control and management of farm capital and the profit margin, have been constructed and used to assess the financial soundness of the Canadian agricultural sector.

To understand the financial situation in agriculture, one has to understand the past. The present situation mainly results from the indebtedness incurred during the inflationary decade of the 1970s, the surge in interest rates and input costs, the decrease in commodity prices and the resulting drop in farm asset values. This appears to have been dramatic for a small portion of farmers who have a large asset base.

Although, overall, net farm income has drop[ped] in the early 1980s, the average cash flow remaining after interest payments is significantly above that prior to the 1970s.

However, just over 3 per cent (7000 farm units) of the farm population are experiencing very serious financial problems, particularily among beef and hog producers and some Prairie grain growers. While the debt burden is the main cause of these difficulties, past droughts and collapsing grain prices are compounding the difficulties of western farmers where the financial stress is traditionally linked to income instability.

This report provides an overview of a host of public policies available to the industry and examines ways in which help might be made more effective. These include financial restructuring, flexibility of debt instruments, promotion of equity financing, and strenghtening the extension in technical farm management.

RÉSUMÉ

Le présent document nous fournit les résultats d'un examen de la situation financière actuelle du secteur agricole du Canada. Il tente d'évaluer la gravité des difficultés financières dans leur ensemble, tout en prêtant un intérêt particulier à la catégorie de fermiers dont le fardeau d'endettement est plus lourd.

Pour y parvenir, les auteurs ont pris connaissance des recherches les plus récentes, ont consulté des représentants de groupes de fermiers ainsi que d'institutions financières privées et publiques, et ont examiné les conclusions et recommandations d'autres études. Divers indicateurs financiers, tels que la marge bénéficiaire et le taux de croissance du revenu provenant de la propriété, du contrôle et de la gestion des capitaux des fermes ont été conçus et utilisés aux fins de l'analyse de la santé financière du secteur agricole canadien.

Pour se faire une idée de la situation financière de ce secteur, il importe de bien comprendre le passé. En effet, le contexte actuel résulte principalement de l'endettement occasionné par les poussées inflationnistes des années 70, la hausse des taux d'intérêt et des coûts de production, la chute des prix des denrées et la diminution de la valeur des

actifs. Cette conjoncture semble avoir été tragique pour un petit nombre de fermiers possédant d'importants actifs.

Bien que, dans l'ensemble, le revenu net des fermes ait chuté au début de cette décennie, la moyenne des fonds autogénérés, après paiements d'intérêts, est remarquablement supérieure à ceux d'avant les années 70.

Néanmoins, un peu plus de 3 % (7 000 fermes) de la population des fermiers font face à de très graves problèmes financiers, particulièrement chez les producteurs de boeuf et de porc et certains producteurs de grains des Prairies. Quoique le fardeau de la dette soit la source principale de ces difficultés, les sécheresses passées et la chute des prix du grain viennent encore s'ajouter aux difficultés que les fermiers de l'Ouest - où les contraintes financières sont traditionnellement liées à l'instabilité du revenu - doivent surmonter.

Ce document présente un aperçu d'un ensemble de politiques publiques établies en faveur de l'industrie et examine les moyens par lesquels l'aide pourrait se révéler plus efficace. Notons, entre autres mesures à prendre, la restructuration financière, la flexibilité des contrats d'emprunt, la promotion du financement par actions, ainsi que le développement de la gestion technique des fermes.

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1 INTRODUCTION

The current financial difficulties of Canadian farmers are creating widespread concern. Since 1973, agricultural debt has increased at a tremendous pace and debt servicing has accounted for a growing share of farm expenses. Income from assets (net farm income minus returns to operators and unpaid family labour) decreased in real terms by more than 50 per cent between 1974 and 1984, while interest on debt doubled. Since 1982, gains made on debt have been insufficient to generate positive returns to equity. The consequences of these changes include severe cash flow and liquidity problems for many farmers, some of them highly efficient operators. Recoveries and foreclosures by lenders and bankruptcies of farm operators have increased significantly.

There are fears about the effects of these financial difficulties on the health and stability of the agricultural sector and about repercussions in the farm materials and equipment industries, in financial institutions, in rural communities and regions heavily dependent on agriculture, and throughout the Canadian economy.

This paper presents a review and assessment of the current situation. Our chief concerns were to determine the following:

- How grave are the current difficulties, for the agricultural sector as a whole and for those farmers with the heaviest debt burden?

- To what extent do these problems reflect long-term changes in the nature of agricultural production and related financial changes?

- What adaptations in federal and provincial farm credit programs would be most effective in meeting these needs?

To answer these questions, we reviewed recent research; consulted representatives of farm groups and private and public financial institutions; and examined the conclusions and recommendations of other studies. We looked at key indicators of financial difficulty in agriculture. Where these indicators were lacking, we constructed our own from available data.

The following section of this paper describes the current financial difficulties of Canadian farmers and traces their development from the 1950s. The third section provides an overview of current help available to the industry. The last section examines ways in which help might be made more effective.

Appendix A explains our methodology in constructing financial indicators. Appendix B provides a summary of regional

differences. Appendix C reviews the proposals of two agricultural studies.

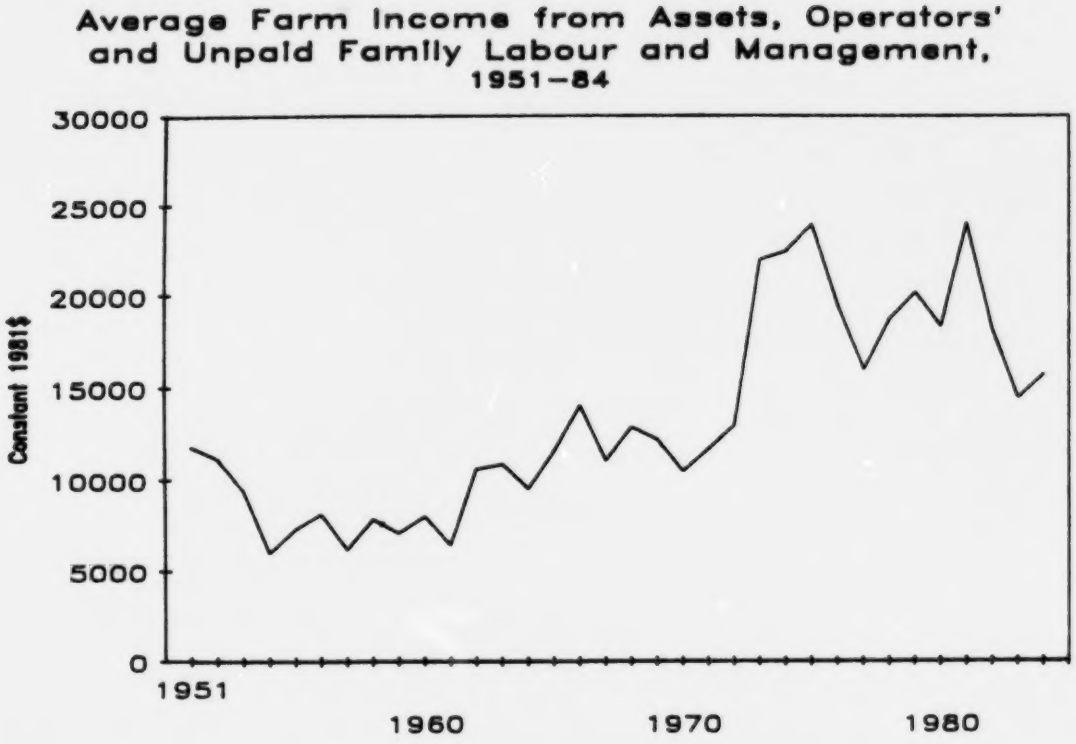
2 THE NATURE OF THE PROBLEM

The financial difficulties facing Canadian farmers today are largely the result of indebtedness incurred during the inflationary decade of the 1970s. Rapidly growing export demand, high inflation levels, low or negative real interest rates, and real rises in the cost of energy-based inputs such as fertilizers and pesticides were the main hallmarks of that period.

Average real farm income from assets and operators' labour reached an all-time high during the 1970s (Figure 1). Real and mostly unrealized capital gains from assets (excluding quotas) were outstanding, peaking in 1979 at over $31,000 per farm (Figure 2). The value of land and buildings increased by an average of 22 per cent a year between 1973 and 1980. This rise in real estate prices provided a seemingly economic rationale for expansion and debt increase. High inflation rates eased the repayment of debt. A similar situation occurred in the United States.

Inflation averaged above 9 per cent annually from 1973 to 1980. Agricultural exports overall did not decrease throughout the

Figure 1



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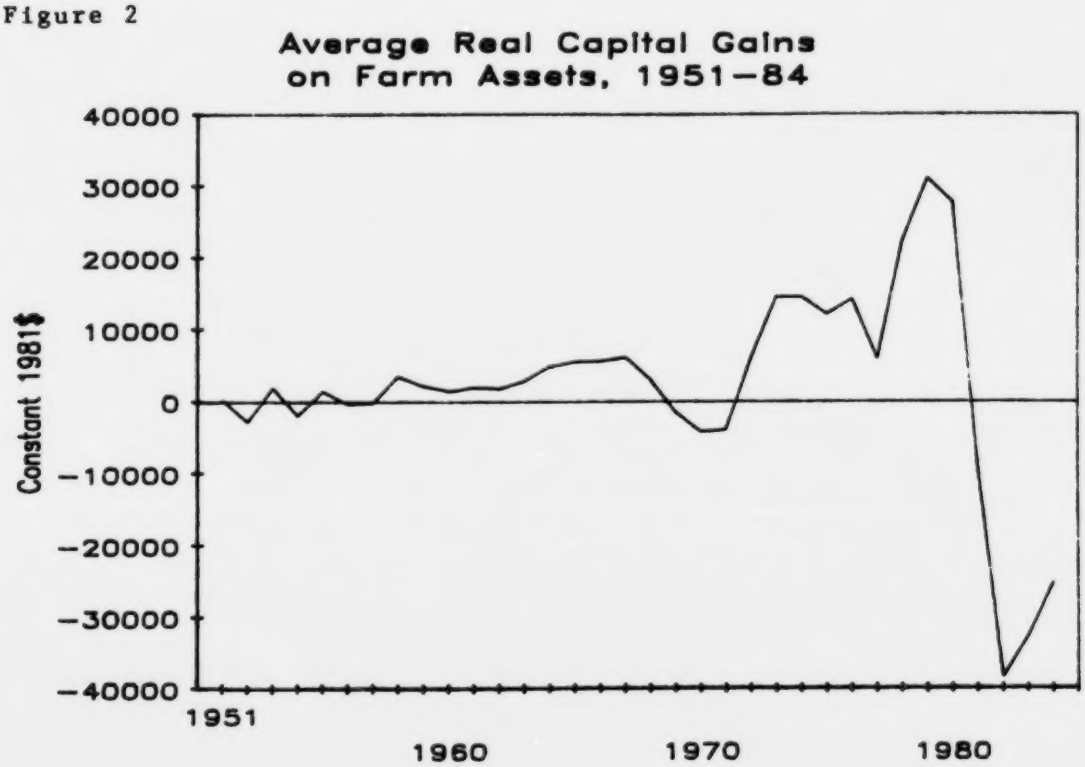


1970s. After the grain export boom of the early 1970s, total agricultural exports were fairly stable from 1974 to 1976. The 1976-77 slide in grain exports was an isolated phenomenon, offset by increased exports in other products. Growth in exports of livestock and oilseed products raised overall exports between 1976 and 1979, and large increases in grain exports were responsible for further gains from 1977 to 1980. Total agricultural exports continued their growth into the 1980s.

Many believed that these trends, coupled with inflation and sustained export demand for agricultural commodities, were going to continue. Expectations seemed to favour the farm sector. Farm credit was readily available and heavy use of debt was supported by the banks, the Farm Credit Corporation (FCC), extension agents, and the agricultural and research community [Deloitte, Haskins and Sells, 1985]. Credit was mainly determined by the value of assets rather than the repayment capacity of the borrower, based on cash flow potential. Some public lenders were allowed to lend or guarantee loans up to 90 or even 100 per cent of most assets.

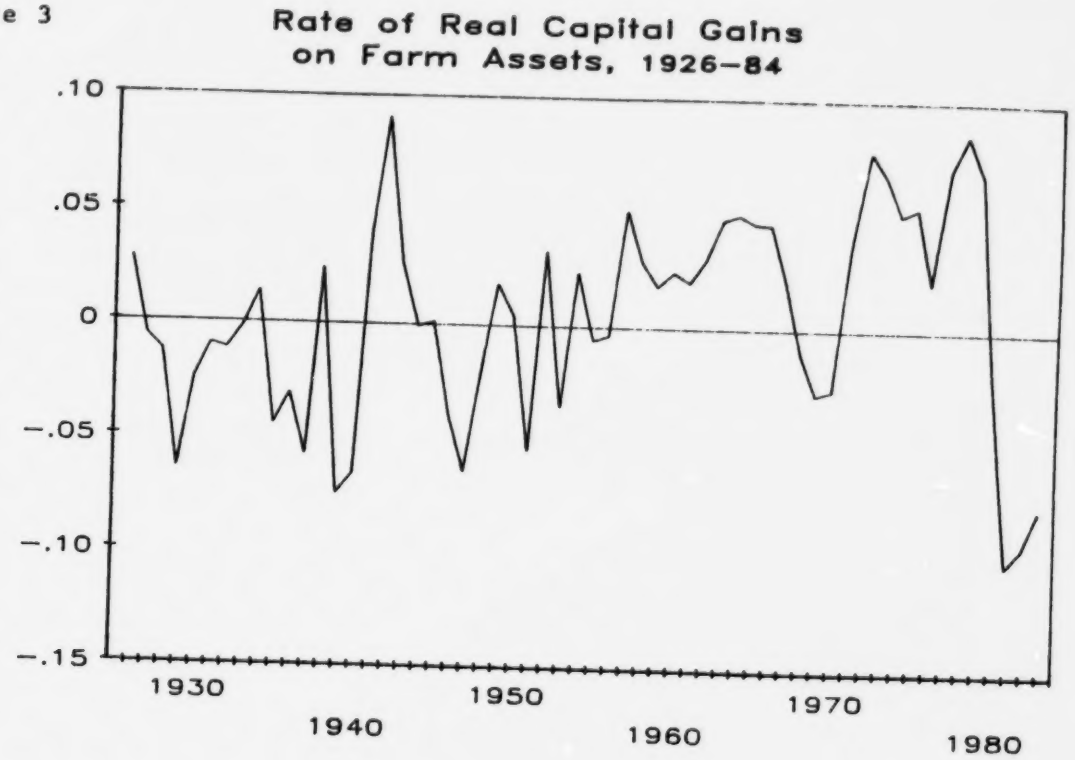
High inflation, low real interest rates, easily available credit, and an optimistic view about the future of agriculture all encouraged Canadian farmers to borrow heavily to finance new capital equipment, land and production quotas. The pattern of rapidly rising values of farm assets provided farmers with an expanded capital base on which to borrow and impelled them to

acquire more assets to realize still further capital gains (Figures 3 and 4).

As a result, by the late 1970s, the average debt load increased and higher real and nominal interest rates dramatically increased the debt service requirements (Figure 5). By the early 1980s, as inflation was brought under control, nominal and real interest rates soared while asset values were adjusted downward to reflect weakening market expectations. At the same time, export demand declined. An abundance of farm commodities in world markets resulted in weak prices, with little or no prospect for improvement in the incomes of farmers who were now coping with high real interest rates on their debt.

Certainly, with hindsight, farmers ought not to have leveraged their operations so as to be so sensitive to the upward spike of interest rates and an agricultural recession. Equally clearly, both private and public lenders ought not to have committed the amount of funds they did, given the particular risk of this type of production. In many cases, the investment was simply too large, the timing proved to be wrong, or the extra capitalization was excessively financed through inflexible debt contracts. Some farmers' organizations, for example, now admit that some investments were excessive or were not justified by the scale of the basic operations (e.g., Union des producteurs agricoles du Québec, pp. 28, 49).

Figure 3



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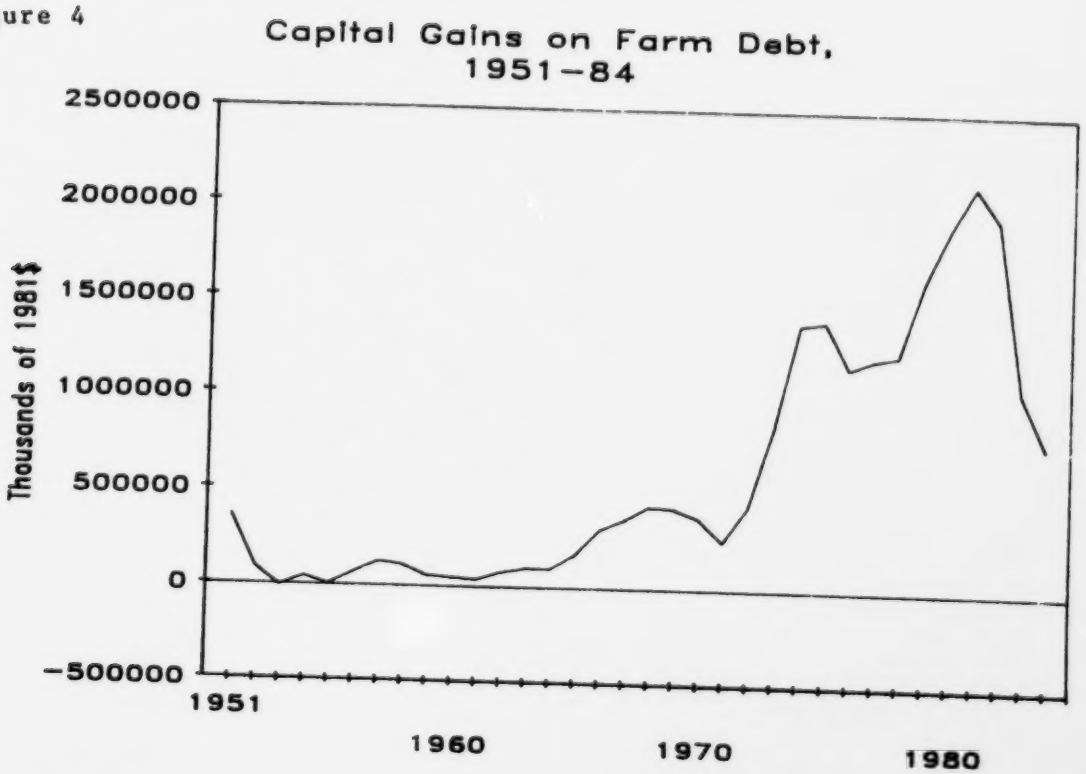

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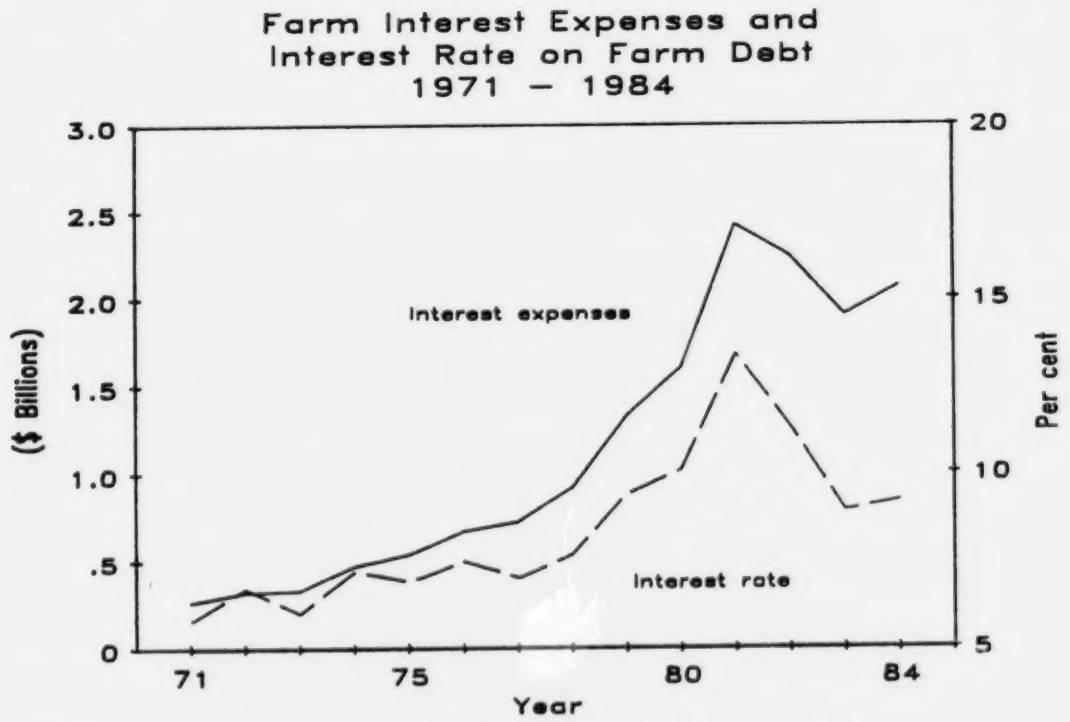


Source Based on data from Statistics Canada

Because of the expansions that took place in the late 1970s and the stagnation and decline in asset values starting in 1981, some farmers found their debts exceeding the value of their assets, and their income in relation to the debts so low as to bring the interest coverage ratio to unprecedented lows. Despite the relative stability of the profit margin at around 15 per cent of gross income, the interest coverage ratio (the ratio of income from assets and operator and unpaid family labour and management to interest paid on farm debt) had already started to drop before the 1970s as more inputs were purchased and the capital investments due to the mechanization required more extensive use of debt financing instruments.

Between 1973 and 1983, the outstanding debt to agriculture increased more than 14 per cent annually (Table 1), while by 1984 constant dollar interest expenses were nearly three times those in 1971 (Figure 6).

By 1984, the average net farm income (from assets and operators' labour) was still above that in 1970 by 861 million of 1981 dollars, but real asset values had nearly doubled in those 13 years. In fact, income from assets as a percentage of assets remained close to the average for the 1960s (Figure 7).

Net farm income was fairly constant at about 3.4 billion dollars from 1973 to 1984 (Figure 8). In real terms, however, it

Table 1

Farm Debt, Implicit Interest Rate and Conventional Mortgage Rate, 1971 to 1984

	Farm debt	Annual rate of increase	Implicit interest rate on farm debt	Average conventional mortgage rate*
	(Millions of current dollars)	(%)	(%)	(%)
1971	4,564.3	5.9	5.8	
1972	4,830.8	5.8	6.7	
1973	5,557.0	15.0	6.0	9.6
1974	6,529.7	17.5	7.2	11.2
1975	7,828.7	19.9	6.9	11.4
1976	9,057.9	15.7	7.5	11.8
1977	10,306.7	13.8	7.0	10.4
1978	12,013.4	16.6	7.7	10.6
1979	14,156.5	17.8	9.4	12.0
1980	15,875.9	12.1	10.1	14.3
1981	18,133.5	14.2	13.4	18.1
1982	19,822.6	9.3	11.3	16.9
1983	21,267.0	7.3	8.9	11.0
1984	22,540.0	6.0	9.2	12.0

*1981 to 1984: Average chartered bank typical one-year mortgage rate.

Sources Statistics Canada, Handbook of Net Farm Income.
Bank of Canada, Bank of Canada Review, various issues.

Figure 6

Figure 7

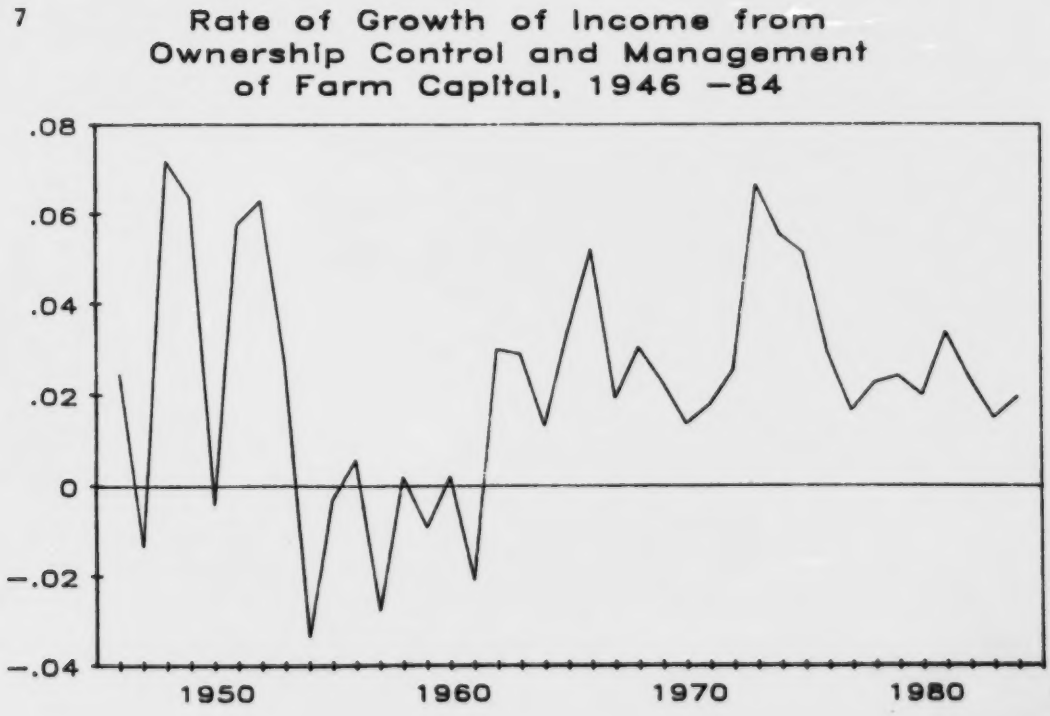
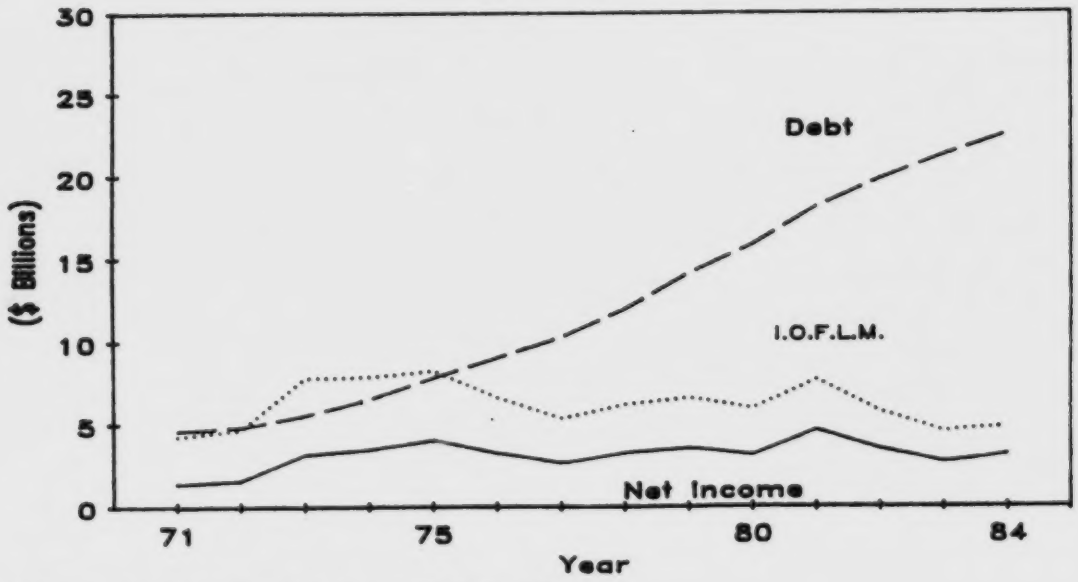


Figure 8

Farm Debt, Net Income, and Income from Assets Operators' and Unpaid Family Labour, and Management, 1971 – 84



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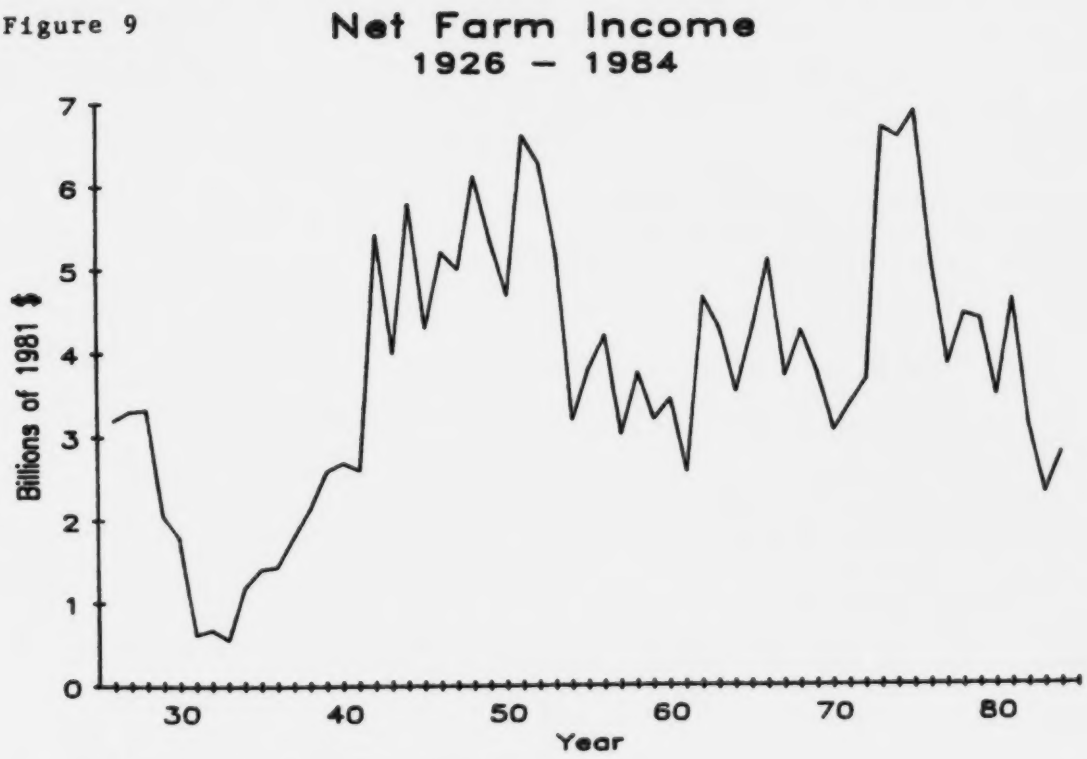
gradually fell from 6.7 to 2.6 billions of 1981 dollars during this period, a decline of 62 per cent. In real terms, net farm income in 1984 was at the lowest level in over 40 years (Figure 9). (The net farm income measure is not the appropriate measure of the profitability of the sector. It only shows the symptom of the current difficulties.) Stable current dollar income and large capital appreciations provided something of an illusion of well-being and a rise in off-farm income offset some farm income losses. Off-farm income, a growing source of income for most farmers for decades, became increasingly important. In 1982, 1983 and 1984, off-farm income as reported in tax-fillers data reached 80 per cent of total income of farm taxfilers. However, off-farm income represents a larger proportion of total income of farmers with small farms or relatively small gross farm income. On average for 1984, taxfilers with gross farm income above $50,000 reported that 60 per cent of their income was generated on the farm while taxfilers with smaller scale farm operations (two-thirds of the individuals reporting positive gross farm income) reported their main source of income to be generated off the farm mainly from wages and salaries. In addition, large unrealized capital gains constituted sizeable saving reserves, and expectations of further capitalization of the farm rent were optimistic [Farm Credit Corporation, 1985].

But with the cooling of inflation, along with the reduction in relative demand due to large world supplies and the recession,

Figure 9



Source Based on data from Statistics Canada

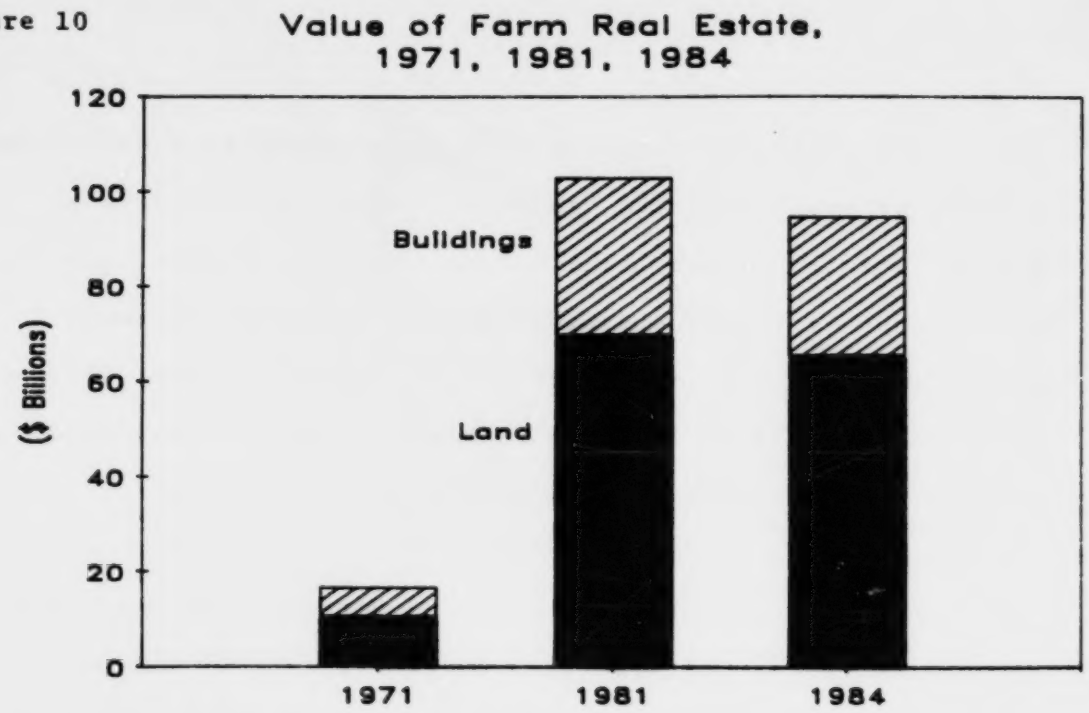
prospective buyers of farmland once again began to consider land in terms of its productive capacity, rather than as a hedge against inflation. Many land values could not support the valuations they received from inflation (Canadian Bankers Association, p. 8). Thus asset values started to drop (Figures 10 and 11) and it was no longer possible to monetize capital gains to increase the liquidity of farm firms.

The long-term trend toward fewer and larger farms continued through the 1970s. Between 1956 and 1981, the total farm population decreased steadily from about 2.8 million to about 1 million. The number of farms decreased by nearly 200,000 from 1961 to 1981, while average farm size increased from 350 to 500 acres.

The high rate of exit from agriculture, enlargement of existing enterprises, and regular refinancing of the whole capital base contributed to the expansion of interest expenses relative to farm income. By the early 1980s, however, the conjunction of firm debt contracts and lower commodity prices pushed the ratio constantly downward (Figure 12).

Although the secular trend toward fewer and larger farms continued during the last 25 years, the increased profitability of farming in the 1970s caused the net rate of exit from agriculture to decline by 17 per cent between the periods 1966-76 and 1976-81.

Figure 10



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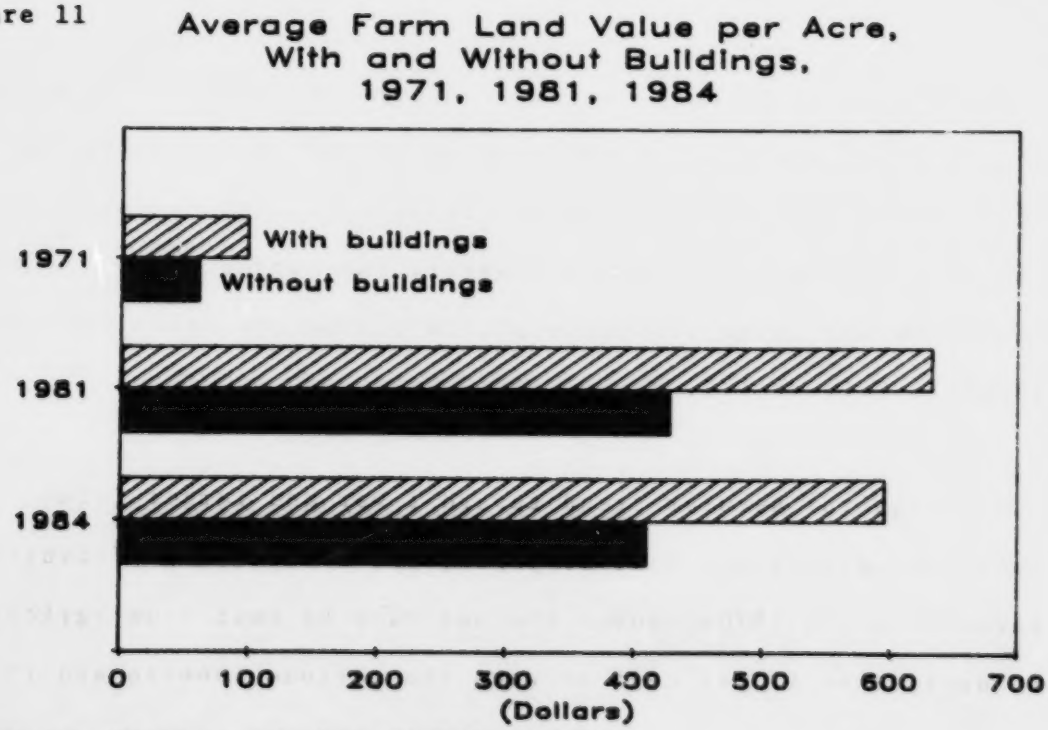
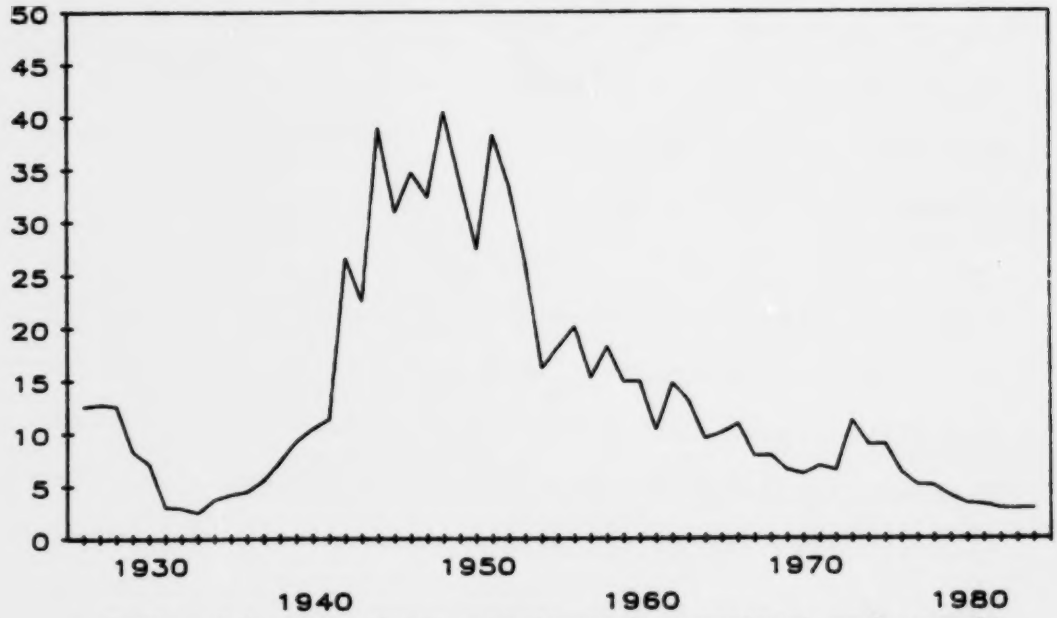


Source Based on data from Statistics Canada.

Figure 12 **Interest Coverage Ratio* in Agriculture, 1926 – 1984**



* Ratio of income from assets and operators' and unpaid family labour and management to interest on farm debt.

During the 1971-76 period, while the proportion of operators retiring or exiting remained at the same level as in the late 1960s, the proportion of entrants was larger. By the second half of the 1970s, the proportion of entrants declined to the 1960s level but fewer were exiting than in the previous decade. This 1976-81 reduction in the gross rate of exit was mainly due to lower retirement rates of operators of 45 years of age and more (Kapitany and Bollman, 1983). Some of these older producers may have been tempted by capital gain expectations to secure themselves better retirement conditions.[1]

Many of the older farmers left agriculture when prices, incomes and asset values dropped. The FCC Farm Survey [FCC, 1984, pp. 42-47] shows that between 1981 and 1984, the average age of farm managers declined for farms with low and high sales and remained constant in the medium sales class. This indicates that from 1981 on, the gross rate of exit of older operators was somewhat restored to previous levels. Older producers who held on during the times of outstanding capital appreciations made their way out as the profitability situation deteriorated, and the 3 per cent decline in the farm equity ratio between 1981 and 1983 may partly be understood as the result of the change in the rate of exit. The other main reason was the decrease in asset values.

The agricultural sector has often experienced rough times before. In the late 1960s, for example, the profit margin slid

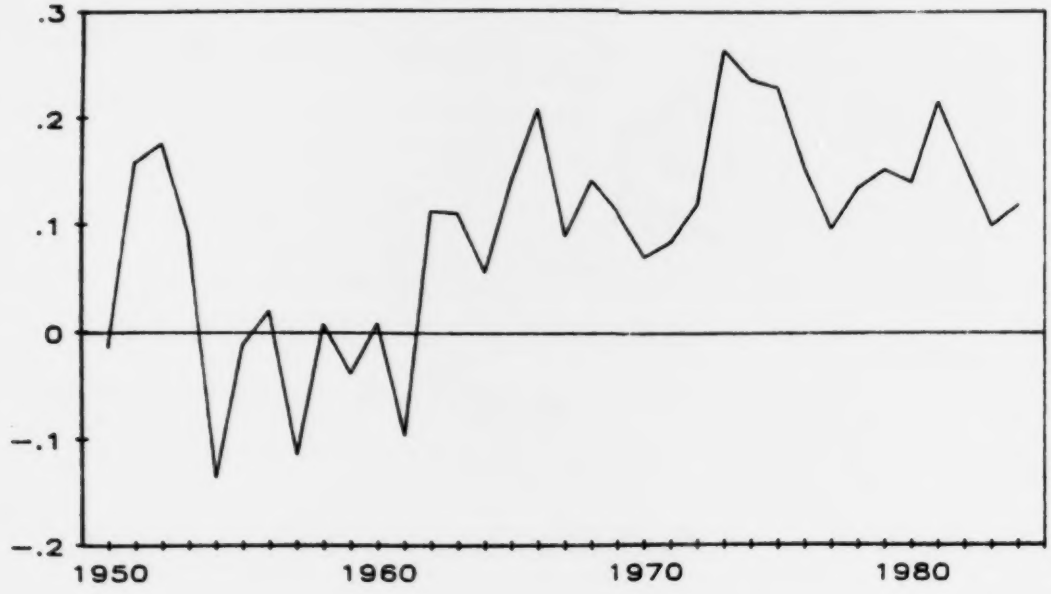
under 10 per cent (Figure 13) and real capital losses were experienced when average interest charges per farm came close to 2,000 of 1981 dollars. In the 1950s, severe droughts, price declines and adjustments after World War II seriously reduced the farm profit margin. But financial problems were less severe because farm debt was relatively low. In the 1950s, the average equity ratio was around 90 per cent and the income available for debt repayment averaged more than 15 times the interest charges.

Another change that contributed to the downturn was the growing interdependence between agriculture and the other sectors of the economy. More debt financing and greater use of purchased inputs accentuated a price cost squeeze as interest rates shot up and input prices rose faster than farm prices. Interest payments as a percentage of farm cash flows increased sharply from 1973 (Figure 14).

The most striking characteristic of the 1980s downturn is the tremendously high value of all variables involved. By 1984, the average gross farm income was nearly twice that in 1970, average operating expenses excluding interest had more than doubled in 15 years, and interest charges more than tripled from about $1,700 per farm in 1970 to nearly $5,600 in 1984 (Figure 15). As a result, the aggregate real net farm income is significantly reduced (see page 6).

Figure 13

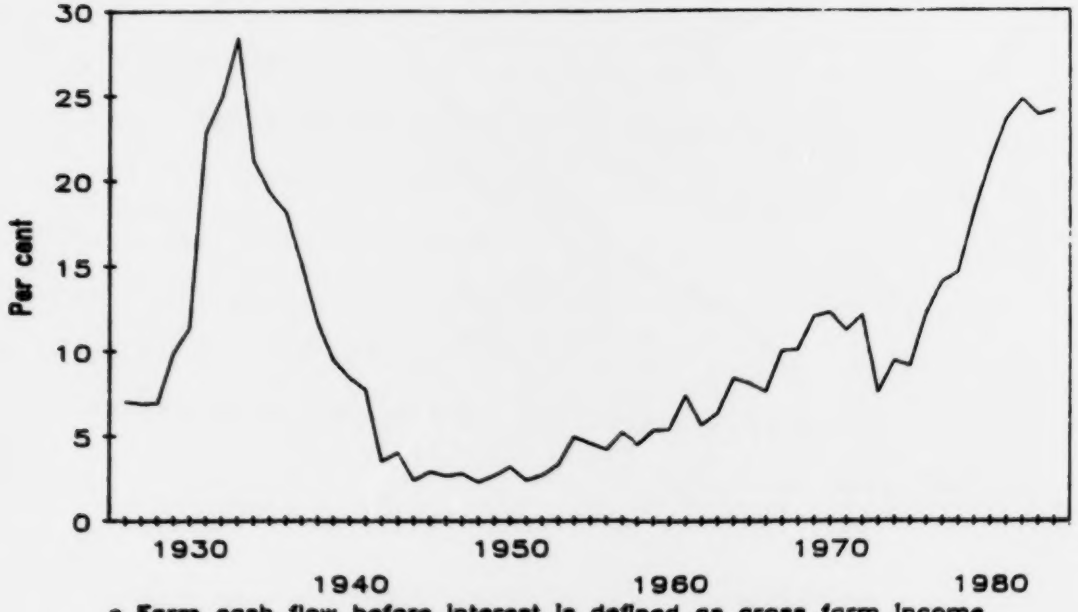
Profit Margin* in Agriculture, 1950 – 1984



* Income from assets and management over gross farm income.

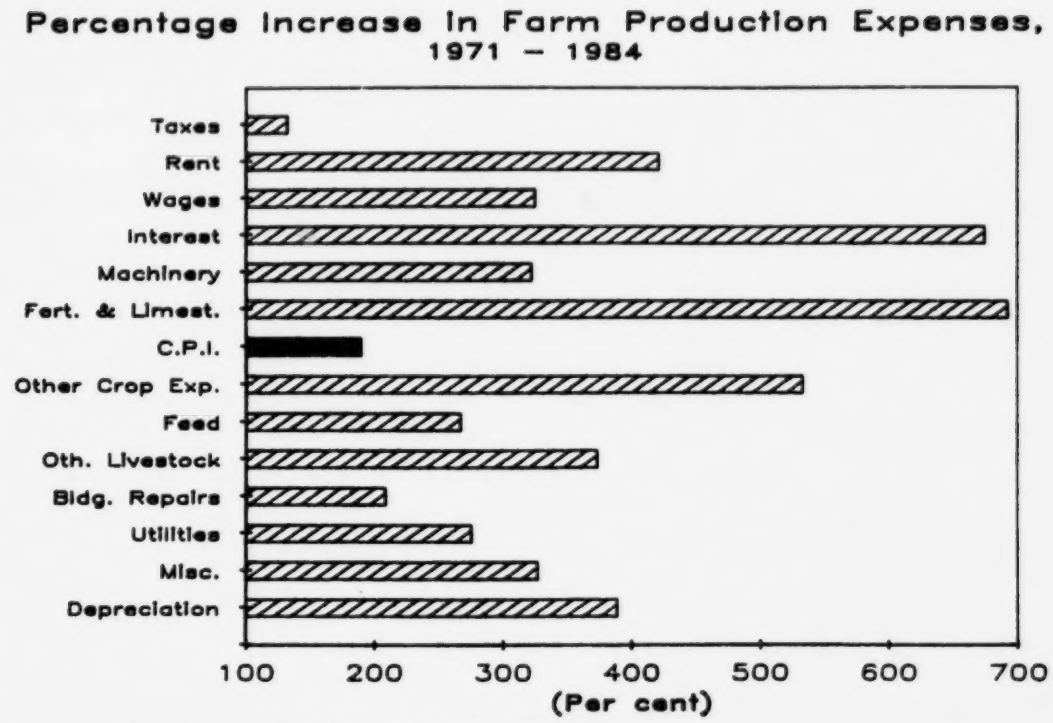
Figure 14

Interest Payments as a Percentage of Farm Cash Flow Before Interest,* 1926 – 1984



* Farm cash flow before interest is defined as gross farm income minus wages paid to farm labour and other operating expenses.

Figure 15

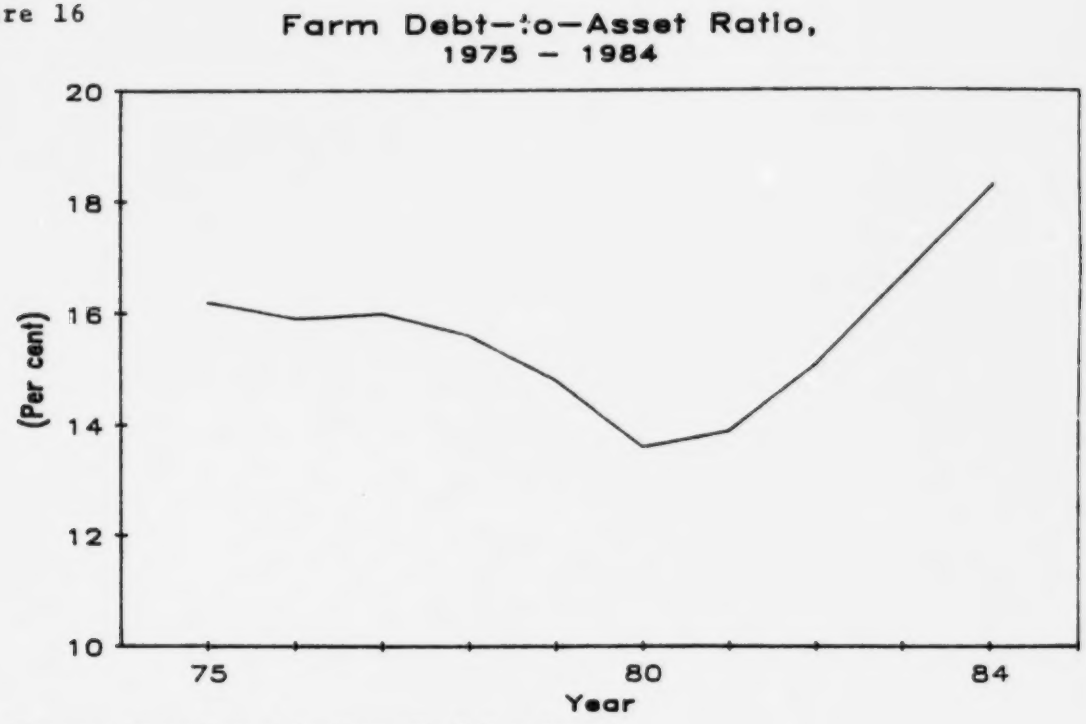


Source Based on data from Statistics Canada.

The decline in asset values, the largest in more than forty years, contributed significantly to the sharp increase in the farm debt-to-asset ratio (Figures 16 and 17). Most of the losses experienced from 1981 are attributable to the fact that asset values no longer increased faster than inflation, but instead began to lag, although nominal asset values declined only in 1983 and 1984.[2] Average unrealized farm capital losses since 1981 totalled near 100,000 of 1981 dollars per farm, while the value of the industry's capital base lost more than $8.5 billion. This resulted in negative returns to assets which offset the capital gains from debt and led to three consecutive years of negative returns from overall farm equity (Table 2). Of course, this is not the story of all farms: the average need to be relativised by the size of the farm, the type of production, the location of the land and the ability of the operator.

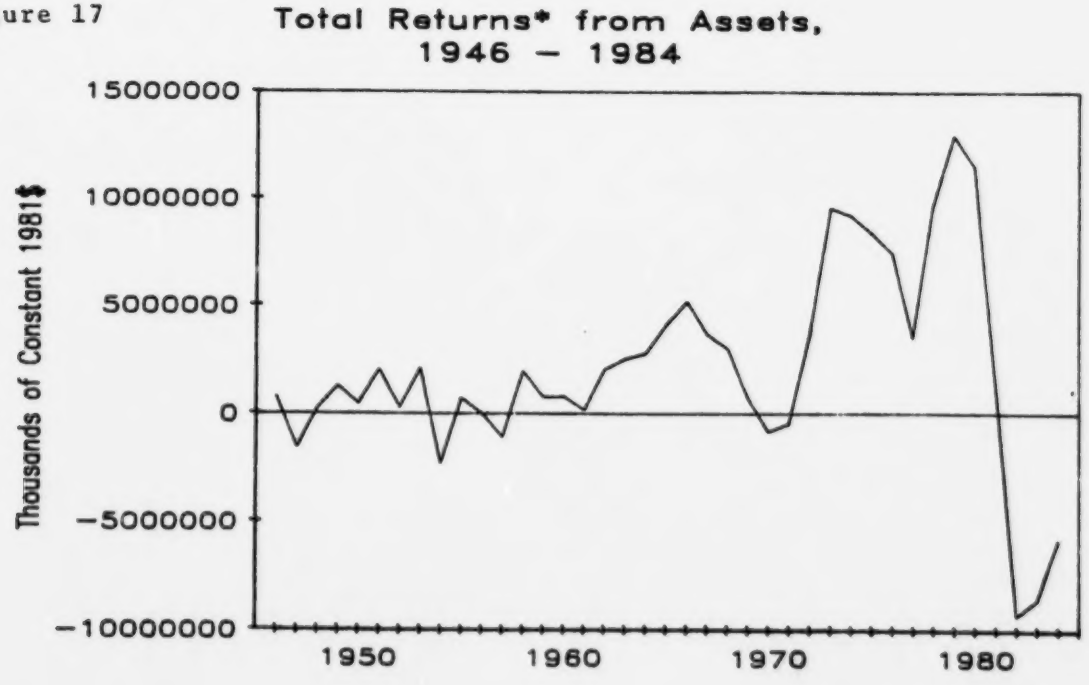
The interest coverage ratio declined from 10.6 in 1973 to 2.4 in 1983 and 1984. This means that interest expenses represented 9.4 per cent of the net farm income in 1973 and 42 per cent in 1983 and 1984. In terms of cash flow (the measure of liquid inflows available to meet interest obligations), interest expenses amounted to over 12 per cent of the aggregate farm cash flow in 1970 and under 8 per cent of cash flow in 1973. In 1983 and 1984, interest expenses represented 24 per cent of cash flow.

Figure 16



Source Based on data from Statistics Canada.

Figure 17



* See table 5 for a definition.

Table 2

Income, Returns, Rates of Return and the Profit Margin in Agriculture, 1970-1984

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
							(Millions of 1981 dollars)								
GROSS INCOME	10,855	11,627	12,406	16,684	17,562	18,437	17,014	15,837	17,344	18,624	18,448	20,388	17,741	16,204	16,419
Less: Wages paid to farm labour	690	721	733	872	858	950	954	992	982	1,015	1,020	1,073	1,050	1,059	1,076
Less: Other operating expenses (excluding interest)	4,880	5,334	5,673	6,609	7,247	7,350	7,350	7,317	7,841	8,522	8,885	9,026	8,521	8,331	8,305
Less: Depreciation charges	1,326	1,291	1,319	1,379	1,585	1,887	2,109	2,185	2,321	2,492	2,632	2,628	2,455	2,334	2,217
Equals: Income from assets, operators' labour and management	3,959	4,281	4,681	7,824	7,872	8,250	6,601	5,345	6,201	6,596	5,910	7,661	5,715	4,480	4,820
Less: Income imputed to operators and unpaid family labour	3,192	3,290	3,180	3,417	3,724	4,033	3,974	3,802	3,849	3,753	3,319	3,261	2,930	2,867	2,869
Equals: Income from ownership, control and management of farm capital	767	991	1,501	4,407	4,148	4,217	2,628	1,540	2,352	2,843	2,591	4,400	2,785	1,613	1,951
Plus: Real capital gains on assets	-1,618	-1,455	2,165	5,166	5,045	4,150	4,815	1,954	7,374	10,127	8,902	-3,030	-12,118	-10,180	-7,788
Equals: Total returns from assets	-850	-464	3,666	9,572	9,192	8,368	7,442	3,494	9,726	12,970	11,493	1,369	-9,333	-8,567	-5,837
Less: Interest paid	647	622	726	696	889	922	1,061	1,056	1,244	1,647	1,796	2,424	2,022	1,621	1,695
Plus: Real capital gains on debt	371	251	434	849	1,385	1,404	1,161	1,211	1,234	1,622	1,899	2,127	1,945	1,051	768
Equals: Total return on equity	-1,126	-836	-3,374	9,725	9,689	8,849	7,542	3,649	9,716	12,945	11,595	1,072	-9,409	-9,137	-6,763
							(Per Cent)								
Income from assets	1.3	1.8	2.6	6.7	5.5	5.1	2.9	1.6	2.3	2.4	2.0	3.4	2.3	1.5	1.9
Real capital gains	-2.8	-2.6	3.7	7.8	6.7	5.1	5.4	2.1	7.1	8.6	6.8	-2.3	-10.2	-9.4	-7.7
Total returns from assets	-1.5	-0.8	6.2	14.5	12.3	10.2	8.3	3.7	9.4	11.0	8.8	1.0	-7.9	-7.9	-5.8
Interest on debt	6.3	5.8	6.7	6.0	7.2	6.9	7.5	7.0	7.7	9.4	10.1	13.4	11.3	8.9	9.2
Real capital gains on debt	3.6	2.4	4.0	7.3	11.3	10.5	8.2	8.1	7.6	9.3	10.7	11.7	10.9	5.8	4.2
Total real cost of debt	2.7	3.4	2.7	-1.3	-4.1	-3.6	-0.7	-1.1	0.1	0.1	-0.6	1.7	0.4	3.1	5.0
Return on equity	-2.4	-1.9	7.0	17.8	15.5	12.9	10.0	4.6	11.1	12.9	10.3	1.0	-9.3	-10.1	-8.2
Profit margin	7.1	8.5	12.1	26.4	23.6	22.9	15.4	9.7	13.6	15.3	14.0	21.6	15.7	10.0	11.9

2.1 The Severity of Current Farm Financial Problems

In Manitoba and Saskatchewan, the burden of the debt seems to be of less importance than in other provinces. In these provinces, the financial stress can be attributed mainly to the market risks - in other words, to the instability of income (see Appendix B and page 18).

Because of these cash flow difficulties, farmers began to restructure a considerable portion of their agricultural debt into longer-term liabilities, to improve the probability of farm survival. According to the FCC's 1984 Farm Survey, between 1981 and 1984 total long-term debts in Canadian agriculture increased by 20 per cent in nominal terms while total long-term assets decreased by about 5 per cent. Current and intermediate liabilities increased as well. As a result, the average farm equity ratio dropped from 85 to 82 per cent, which is still a safe level for the industry as a whole.[3] In contrast, the average U.S. farm equity ratio was 79 per cent in 1983 (Melichar, 1984, p. 8).

Virtually all farmers have experienced a tightening of their cash flow situation. The most critically affected are those whose equity in relation to assets is under 50 per cent, about 10 per cent of the farm population. Those whose equity level is less than 25 per cent are relatively few in percentage terms -- just over 3 per cent of the farm population, or nearly 7,000 farm

units. They include all types of farms, but serious financial problems seemed particularly pronounced among beef and hog producers and some Prairie grain growers and cattlemen.

A particularly unsettling fact is that many are above average producers. Gross sales of farmers with less than 25 per cent equity are 41 per cent larger than the all-farm average (Table 3). Current financial difficulties in the sector are thus threatening the existence of significantly productive businesses.

Financial problems are reflected in the number and magnitude of arrears registered in financial institutions. One of every eight FCC accounts was in arrears by more than $500 on March 31, 1984, while the amounts in arrears increased by 40 per cent over the previous year. Admittedly though, FCC clients are generally thought as higher risk farmers and probably heavier debt users than average. Less than one of every 15 accounts were in arrears at the Office du Crédit agricole du Québec (OCAQ) for 1984-85. Furthermore, to put the percentage of FCC accounts in arrears in perspective, more than one of every seven and one of every nine corporation's accounts were in arrears respectively in 1971-72 and 1972-73.

An analysis of the FCC 1984 Farm Survey data reveals that the group of farms with less than 20 per cent equity (henceforth the "low-equity group") had in fact a negative net worth in Ontario,

Table 3

Selected Statistics from 1984 FCC Survey, by Equity Levels

	Equity					
	Less than 25 %	25-50 %	50-75 %	75-100 %	0-50 %	Total
Number of farmers	7,477	13,826	42,193	165,255	21,303	228,751
Percentage of farmers	3.3	6.0	18.5	72.2	9.3	100.0
Average assets ($'000)	362	453	554	506	421	508
Average liabilities ($'000)	335	273	199	36	295	91
Average net worth ($'000)	26	180	356	470	126	417
Average equity (%)	7.3	39.8	64.3	92.9	30	82.2
Total assets as a % of assets	2.3	5.2	19.7	72.8	7.5	100.0
Total liabilities as a % of all liabilities	12.0	18.1	40.2	29.7	30.1	100.0
Average gross sales ($'000)	127	139	131	74	135	90
Total sales as a % of all sales	4.5	9.2	26.3	60.0	13.7	100.0
Average interest expense	24,177	26,372	19,868	4,000	25,604	8,817
As a % of average sales	19.0	19.0	15.2	5.4	19.0	9.8
Average off-farm income	7,285	8,656	10,566	8,745	8,176	9,021
Interest expense as a % of all interest expense	8.7	17.7	40.5	33.1	26.4	100.0

Note "The target population for the survey was drawn from the 1981 Census of farm population. Certain farms not considered to be of interest to (the FCC) Survey were not sampled. These were: institutional farms, farms in Indian reserves, community pastures, farms with reported sales agricultural products of less than $2,000 in 1980, farms in marginal areas which have little or no agricultural activity, and farms which were part of large multiple farm operations, owned by large corporations." Farm Credit Corporation, p. 75.

Source W. Jones and J. Caldwell, "Farm Finance", in Market Commentary, Farm Inputs and Finance, Agriculture Canada, Regional Development Branch, Ottawa, December 1984, p. 87.

Table 4

Equity Ratios by Farm Types, Canada and Provinces, 1981 and 1984

	British Columbia		Alberta		Saskatchewan		Manitoba		Ontario		Québec		Atlantic		Canada	
Farm Type	1981	1984	1981	1984	1981	1984	1981	1984	1981	1984	1981	1984	1981	1984	1981	1984
	(Percentages)															
Cash Crops	80.4	80.2	90.7	85.2	83.1*	85.8	85.1	84.5	83.7	78.7	82.6	71.9	79.1	81.7	85.3	83.9
Dairy	78.5*	77.4	82.3*	75.1	86.8*	60.2	87.1*	68.1*	83.8*	82.5	79.6	77.3	85.6	79.5	82.1	78.3
Hog	-	62.4*	71.5*	74.7*	61.4	59.1*	63.3*	62.1	70.3	63.9	61.6	49.0	79.3*	63.6	68.6	63.6
Beef	-	86.7	90.2	83.8	85.1*	78.0	86.8	83.5	83.3	86.6	90.9	82.5	93.9*	93.8*	87.8	84.1

*Denotes a coefficient of variation exceeding 25 per cent for either total assets or total liabilities or both.

Source FCC 1984 Farm Survey.

Quebec and the Maritimes. Most of the Ontario and Quebec farms with negative average net worth are hog farms (Table 4).

This "low-equity group" may include efficient farmers; it generates more than twice (in Ontario) and three times (in Quebec) the average gross farm sales of farms with more than 90 per cent equity with about the same average asset values. Although, on average, the "low-equity groups" in Quebec and Ontario are technically bankrupt, their ratio of interest charges over sales is far from the largest among all equity groups. Indeed, since they have a relatively larger amount of cash flow available for other operating expenses than other equity groups, this implies that many have not yet reached the stage of insolvency. Their negative net worth position may reflect the bad timing of their entrance into the industry with little or no equity, and their consequent vulnerability to the recent decline in the market value of assets. Any improvement in asset values in the near future would restore the equity position of the efficient farmers in the low equity group. Farms with above zero equity can use the debt restructuring process to improve their liquidity.

The general financial difficulties of farmers are exacerbated by market adjustment problems specific to particular types of production and particular regions.

1. Beef farmers face declining per capita demand due to changes in consumer tastes, mainly in favour of poultry, and increased competition from abundant supplies of pork and from imports of heavily subsidized beef from the European communities. Western beef farmers, particularly in Alberta, have faced increasing costs since early 1984, due largely to drought-induced increases in barley price. Severe drought conditions in southern Saskatchewan and Alberta since early 1984 are continuing to weaken the financial position of beef (and grain) farmers, as of August 1985. Drought-induced hay shortages have raised feed prices and prompted many cattlemen to reduce their herds further.

2. Pork producers had to cope with the impact of countervailing duties imposed on the Canadian hog exports imposed by the United States between April and July 1985. These duties reduced the Canadian price by nearly the full amount of the tariff, widening the price margin between Canadian and U.S. hogs which has favoured U.S. hog prices since 1982, when Canada moved to a full export basis. Farmers in less-subsidizing provinces such as Ontario suffered the most from the tariff, since it was set according to the Canadian average subsidy for all provinces. This sudden price change may have temporarily deteriorated the financial position of those producers already experiencing difficulties. Duties on Canadian shipments of pork meats were removed by the end of

July 1985. Canadian processors were probably the major beneficiaries of the tariff elimination. Countervailing duties on shipments of live hogs are still in place. The margin between Canadian and U.S. hog prices came back to its previous level in the fourth quarter of 1985 following an increased demand by Canadian processors.

3. In the summer of 1985, western grain producers (mainly wheat and barley growers) in southern Saskatchewan and Alberta continued to face drought problems. This was the third consecutive year of reduced yields for some farmers; for most it was also the second consecutive year that crops were being hit by heat, dry weather and grasshopper infestation. Grain production was expected to be 25 per cent below normal in the affected region of Saskatchewan, and production of the six major grains in Alberta production was expected to fall by more than 16 per cent.

However, overall 1985-86 domestic wheat production increased 13 per cent, while total grain production increased 12 per cent. The long-term climatic changes forecast in Environment Canada's Environmental Issues in Canada: A Status Report include more severe droughts in the Prairie region which could reduce agricultural production and increase the risk of farming in the southern Prairies.

Major changes to U.S. grain subsidy policy in 1985 significantly reduced the international floor price for wheat and impacted similarly on other commodities. However, in 1985, U.S. farmers got a target price set 33 per cent above the loan rate (the world price). The target price will be reduced marginally from 1988 while the loan rate will decline 26 to 41 per cent between 1985 and 1990. An increasing share of deficiency payments in farm incomes will result. By 1990, these subsidies could reach between 64 and 108 per cent above the market price for wheat. As stated explicitely by the United States Department of Agriculture, this is a full-blown price war aimed at recapturing the dominant role in world markets. Since no country but the EEC has the budget to match the United States, it is likely that this price war will slow the financial recovery of Canadian grain producers. In addition, exchange rate changes and the U.S. policy (BICEP) of rewarding foreign buyers of U.S. wheat with free wheat out of government surpluses are tightening the market for Canadian growers.

4. Tobacco farmers face production target cutbacks reflecting mainly the changing tastes of consumers. In 1984, Canadian cigarette production declined by almost 5 per cent of the 1977-1981 average. The international situation is not much better. Stronger competition from less developed countries has led to a decline in export demand, which in turn has resulted in a downward pressure on prices.

2.2 Who Are the Farmers Most in Difficulty?

Among the roughly 14,000 farm units having less than 50 per cent equity, the average annual interest burden alone on each farmer's debt was over $25,000 in 1984. Clearly, the most serious problems are being encountered by those farm units with less than 25 per cent equity. While their gross sales are considerable -- as high as the majority of farmers -- the average equity in their farm is less than 8 per cent. On average, while their assets total $362,000, their liabilities total $335,000, leaving an average net worth of about $26,000.

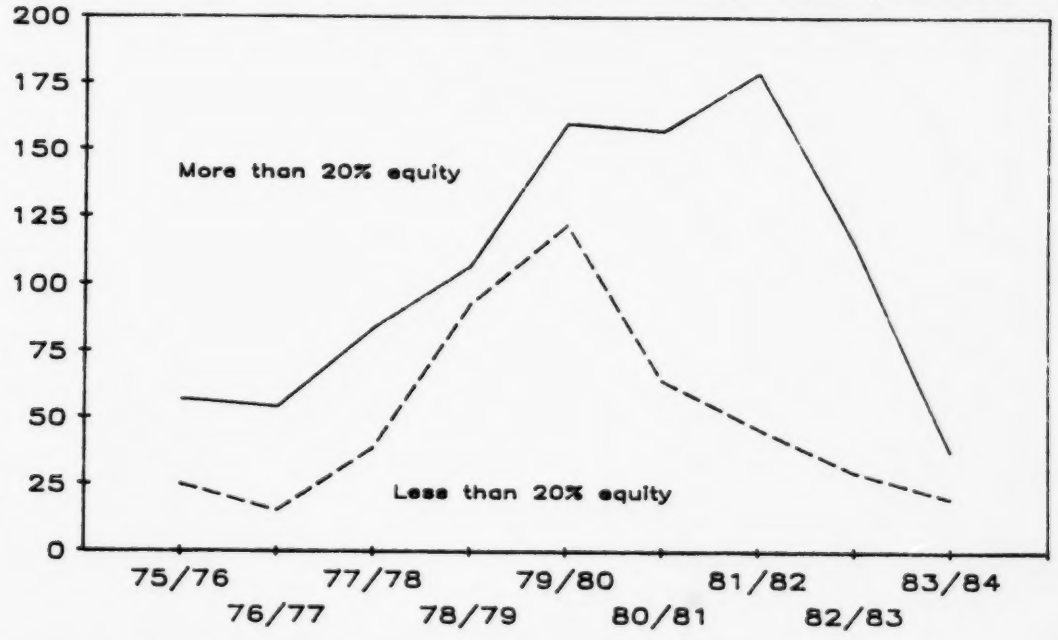
Severe financial difficulties in the primary agricultural sector are mainly related to the indebtedness of farm firms. Farmers experiencing the greatest cash flow difficulties are generally young owners of large, recently acquired operations financed with large amounts of borrowed funds. However, according to the Office du crédit agricole (OCA) du Québec, the youngest producers today are somewhat less financially vulnerable than 35-45 year-old producers. This may reflect the fact that ten years ago, farms were set up with much less equity than today. Credit policies have tightened significantly since the early 1980s, when commodity price started to decline and lenders and borrowers became more aware of the financial risk involved in leveraging farms. Most farms under recovery, foreclosure or bankruptcy today have debts stemming from the easy credit policies during the 1970s.

FCC accounts under recovery, foreclosure or bankruptcy (RFB) are mainly those for which the loan contract was negotiated between 1977-78 and 1982-83.[4] Although farmers who contracted their loan in 1977-78 and 1978-79 may have been misled by erroneous expectations about interest rate movements and inflation, two-thirds of the FCC accounts under RFB carry loans negotiated when real prime rates were above 4 per cent. From 1980-81 on, fewer loans were negociated with farmers with a debt/equity ratio above 80 per cent. This is probably the result of more restrictive lending policies, greater financial vulnerability, and an increased awareness of the financial risk involved in leveraging farms (Figure 18).

The number of farm bankruptcies have increased substantially, from 125 in 1979 to 551 in 1984 (Table 5),[5] and have become more widespread. By far, the greatest number are still in Quebec and Ontario, where they have traditionally been concentrated, but the annual number of bankruptcies doubled in the Prairies provinces in 1983 and 1984, bringing the proportion of western bankruptcies in the Canadian total up to about 40 per cent from an average of about 25 per cent in the preceding years. In central Canada, Ontario farmers traditionally have been most prone to declare bankruptcy, but an increasing proportion of relatively smaller size Quebec units have been hit. In 1979, for example, five out of six bankruptcies in central Canada were in Ontario, but in the following years, the share of Ontario has dropped, with the result

Figure 18

FCC Accounts Under RFB, as of March 31, 1984, and Loans Contracted Since 1975–76, by Equity Level



Source Based on data from the Farm Credit Corporation.

Table 5

Farm Bankruptcies by Regions, 1979-84

	Atlantic Provinces	Québec/ Ontario	Prairies	British Columbia	Canada	As a percentage of all farms
						%
1979	5	79	31	9	125	0.04
1980	7	167	38	10	222	0.07
1981	8	194	51	8	261	0.08
1982	8	319	78	5	410	0.13
1983	17	290	154	26	488	0.16
1984	12	316	184	39	551	0.18

Source Consumer and Corporate Affairs, Bankruptcy Branch.

that in 1984 both provinces shared a nearly equal number of farm bankruptcies.

Over 40 per cent of Canadian farm bankruptcies in 1983 and 1984 have been in the livestock sector and one-quarter in the field crop sector. In central Canada, about half of all bankruptcies involved livestock and livestock combination farms. If combination livestock and field crop mixed operations are added, the proportion increases to close to 60 per cent. In the separate case of hobby farms, a case-by-case study by the Office du crédit agricole du Québec [OCA, 1985a] suggests that bankruptcies or foreclosures have mainly been the result of the sudden off-farm unemployment due to the recent recession.

Although asset values in the 1970s increased less in Quebec than in other provinces, in 1984 Quebec farmers still had the lowest average equity ratio in their farms, with equity representing 75 per cent of assets[6] [FCC, 1984]. This may reflect the greater availability of a lower cost credit than in most other provinces, together with the growing concentration of hog producers who debt financed their entry in the industry.

The new dairy policy in the 1970s, which limited output and contributed to the on-going reduction of the number of farms and the enlargement of existing dairy farms, freed farm resources from the dairy industry. This and strong hog prices, income

stabilization programs, farm credit extension, interest rate subsidies, capital grants and limited opportunities in other agricultural enterprises are all factors that may have contributed to the eastward shift in hog production [Owen, 1984, pp. 1, 3, 8]. This shift in production may be one reason for the financial difficulties of Quebec hog producers, mainly because of its timing.

Kapitany and Bollman's [1983] tabulation of rates of entry (by gross farm sales and type of farms in 1981) indicates that more than half of all hog farms with sales under $5,317 in 1981 were operated by farmers who had started farming between 1976 and 1981. In addition, hog farms and miscellaneous specialty farms[7] have been the only types of farming with a positive net rate of entry between 1976 and 1981, reflecting an increased demand for these products and prices above the marginal cost of production.

Nearly half of RFBs in Quebec between 1979-80 and 1984-85 were hog farms, according to OCA data. However, since April 1979, nearly half (47.3 per cent) of all RFBs among OCA long-term borrowers are attributed to causes which have nothing to do with either the current economic situation or the "pork crisis." Half of these are attributed to bad investment decisions [OCA, 1985a].

The proportion of farms other than hog farms most likely to be experiencing financial difficulties (those with less than 50 per

cent equity) seems to be roughly in line with the numbers cited earlier. Beef and poultry enterprises have been the strongest capitalized. However, for the first time in years, beef farmers as well as hog farmers have seen a severe erosion in their net worth (Table 6). Among all beef farmers surveyed by the FCC between 1981 and 1984, the average values of assets decreased by 15 per cent, whereas liabilities increased by 10 per cent, resulting in an overall decline in net worth of 19 per cent. In real terms, taking account of inflation, this represented a one-third decline in the real net worth of beef farmers, despite their above-average equity situation. Among hog producers, there was a similar pattern of asset deterioration and increased liabilities, resulting in a decline in their net worth of 12 per cent in dollar terms and 29 per cent in real terms, in their net worth. This deterioration has occasioned particularly severe financial problems among Quebec hog producers, despite public supports and interest subsidization.

The erosion of beef farm asset values reflects the uniqueness of the sector. A large component of the productive plant of this industry is the commercial breeding stock which accounts for about 20 per cent of annual production. [Canadian Cattlemen's Association, 1983, p. 3]. Since 1979 the national cow herd has been reduced by 18.2 per cent, following the 1975 to 1979 cyclical decline of 12.9 per cent. While cyclical herd reduction is normal in this industry and producers may have expanded production

Table 6

Selected Statistics from 1984 FCC Survey, by Type of Enterprise

Percent Equity		Type of Enterprise						
		Cash Crop	Dairy	Beef	Hog	Poultry	Other	All Farms
		- (per cent) -						
Equity								
Less than 25 %		2.9 | 8.7	2.3 | 9.1	1.4 | 5.4	15.5 | 26.5	4.6 | 7.4	2.8 | 9.8	3.3 | 9.3
25 % to 50 %		5.8 |	6.8 |	4.0 |	11.0 |	2.8 |	7.0 |	6.0 |
50 % to 75 %		18.4	21.5	13.1	22.8	28.2	15.6	18.5
Greater than 75 %		72.9	69.4	81.5	50.7	64.4	74.6	72.2
		- (dollars per farm) -						
Assets:	1984	570,064	497,476	421,619	383,161	706,382	338,435	508,469
	1981	559,323	459,905	498,782	405,552	NA	NA	518,745
	% change	+1.9	+8.2	-15.5	-5.5			-2.0
Liabilities:	1984	91,841	108,163	66,845	139,604	179,501	51,026	90,618
	1981	81,981	82,361	60,708	127,375	NA	NA	77,888
	% change	12.0	31.3	10.1	9.6			16.3
Net Worth:	1984	478,223	389,313	354,774	243,557	526,881	287,409	417,851
	1981	477,342	377,544	438,074	278,177	NA	NA	440,857
	% change	+0.2	+3.1	-19.0	-12.4			-5.2
Percent Equity:	1984	83.9	78.3	84.1	63.6	74.6	84.9	82.2
	1981	85.3	82.1	87.8	68.6	NA	NA	84.9
	% change	-1.4	-3.8	-3.7	-5.0			-2.7

Source W. Jones and J. Caldwell, "Farm Finance", in Market Commentary, Farm Inputs and Finance, Agriculture Canada, Regional Development Branch, Ottawa, December 1984, p. 86.

excessively by 1975, the reduction started in 1979 is not the result of any cyclical adjustment. The fall in real price for fed cattle, and the rise in the pork and poultry supply and demand, limiting any outlook for price improvement, are part of the reason for this situation. Excess capacity in relation to grazing lands, excessive number of farmers, excess feedlot capacity, excess packing plant capacity and other factors also contributed to the problem.

At present, the situation is such that "Unless the operator holds a high equity position, it has become clear that the beef market is not capable of supporting a capital intensive highly financed operation" (Deloitte, Haskins and Sells, 1985, p. 34).

2.3 Outlook

The financial difficulties experienced between 1981 and 1984 did not disturb the industry greatly in terms of production or the number of farms. However, losses engendered by continued high interest rates, sluggish international demand, weak prices and low incomes could modify the picture of the industry in the medium-term.

The Economic Council's most recent forecast predicts a gradual drop in the prime rate for borrowing. As a result, after an 8 per cent drop in 1985, farm interest expenses are likely to continue

to decrease in 1986 and may stabilize by 1987, depending on changes in the debt levels. Nonetheless, with no major increase in farm prices expected in the next few years, the debt-to-assets ratio for agriculture is expected to increase further in 1986 and 1987, although at a slower pace.

If the real asset values of farm units continue to decline, farmers below the threshold of 50 per cent equity would face continuing financial difficulty and more farms could fall below this equity threshold in the next few years.

Further erosion of asset values and weak commodity prices may mean inevitable failure for the 3.3 per cent of farms with equity below 25 per cent. However, one should probably take into account that a proportion of those farmers supplement their farm income with a sizeable off-farm income. In addition, non-operating interest expenses are fully tax deductible and can easily exceed the income generated on these farms. This could provide tax benefits potentially larger than the income from the assets. These two considerations would probably reduce the estimation of the number of farms in severe difficulties.

The new farm bill in the United States is expected to pull down already depressed grain prices, with low real prices for grains further weakening the financial position of Canadian grain farms and reducing land values. This, in turn, will reduce the equity

level and increase the financial risk of farms already experiencing a weak balance sheet situation. Those most likely to experience severe difficulty are land-intensive farms on marginal farm land of below average quality, which may still be overvalued relative to other land. Identification of this land could provide information on the segment of the industry which will get into more troubles in the years to come.

In the short-term, changes in the relations between farm income and expenses may keep the cash flow position of many farmers above that in 1984, leaving some downward pressures on land prices until the expectations revive about the profitability of agricultural land. In the long run, individual farm incomes could improve if international agricultural supply contracts, if domestic production contracts to meet current domestic and import demand, or if productivity increases and Canadian farmers can gain a larger share of international agricultural trade.

Growth in export opportunities should not be expected in the years to come [Gilson, 1985]. Growth in the EEC share in grain and red meat trade, and uncertainty about export markets like China and the Soviet Union mean that Canadian producers will have to face strong competition in world markets which is unlikely leading to improved prices. Adjustments in the production process and new methods of financing family farm businesses are likely to be the main sources of improvement in farm income.

3 AVAILABLE ASSISTANCE

3.1 Safety Nets for Market Risks

Canadian agricultural stabilization programs have been designed largely to help farmers cope with the short-term financing needs. These price and income programs are not intended to interfere with long run market adjustments. This stabilization approach implies that Canadian producers ought to adapt to longer-term market signals through proper resource allocations.

Under the Agricultural Stabilization Act, producers of nine named commodities and of other commodities designated by Order-in-Council are guaranteed 90 per cent of the past five year average price. The indemnity is paid to the producer in the form of a deficiency payment. These deficiency payments can be adjusted upward according to changes in estimated costs of production.

The Initial Payment System of the Canadian Wheat Board sets a floor price for grains produced in the Prairie Region and the Two-Price Wheat Act fixes a floor price to wheat sold to domestic millers.

Indemnity payments are made to participating producers under the Western Grain Stabilization Act cover the full difference between current net cash flows and the average for the previous three

years. This program has been modified recently to ease the cash flow situation of grain farmers.

Individual participating producers are insured against losses from natural hazards through the crop insurance programs. These provincially administered programs cover the cost of purchased inputs only. No account is made of interest charges and principal repayment schedules. These plans are intended to supplement federal income support and stabilization programs. They tend to focus on red meat production and to emphasize a level of support in relation to actual production costs.

Finally, the supply-managed commodity sector uses a range of price setting mechanisms reflecting production costs, quota allocations, levies, subsidy (dairy) and import restrictions to stabilize farm prices and incomes and minimize market risks.

It is clear that many of these programs are not designed to compensate for weak prices over an extended period (e.g. programs under the Agricultural Stabilization Act and the Western Grain Stabilization Act). Payments drop as the calculations are made with more low-price years.

On the other hand, after the first generation of benefiting farmers, the increasingly high value of quotas for supply-managed commodities tends to reduce the liquidity of farms and the ability of farmers to respond to unexpected events like high interest

rates because of an increased leverage. In other words, in the long run, the quota values may increase the financial risk of the industry.

Most of these programs are not intended to relieve the burden of large interest payments or to counteract downward trends in asset values, although under supply management quota values do contribute to the growth of asset values. (However, quota values where excluded from the assets considered in this report.) What these programs do accomplish, however, is to reduce the risks inherent to agriculture by spreading them among the participating producers and among all tax payers. They enable farmers to make decisions independently of large short-term market fluctuations. Some measures have been implemented recently to provide more direct help for farmers with financial difficulties.

3.2 Recently Implemented Measures

Some special federal and provincial measures have recently been implemented to deal with the current financial stress in the industry. Most of these are concerned with the level of interest rates. Some are also aimed at freeing funds to agriculture in times of credit-tightening,[8] while other measures provide counselling, subsidies and adjustments of existing programs.

3.2.1 Interest Rates Below Market Rates

- On February 26, 1986, a federal $700 million farm loan program was announced which ties loan payments to the price of farm commodities. Under the program, farmers with equity of 40 per cent or less are eligible for loans with an interest rate of 6 per cent. Those with up to 55 per cent equity would get a rate half-way between the 6 per cent base and the going FCC rate for 10-year, fixed-term mortgages.

- As of April 1, 1985, the FCC is offering shared risk mortgages with an annually adjusted interest rate and an interest rate increase ceiling of 2½ per cent over the six-year term. Changes in interest rates will be cut in half up to the 2½ per cent limit in case of increases. Repayments can be adjusted according to interest rate changes or can be fixed for the six-year term, with the portion going to capital repayment varied according to the current interest rate.

- FCC interest rates have recently been reduced a number of times. A range of 12 to 13½ per cent, depending on the loan and the term, has been in effect since May 6, 1985. However, this is mainly the result of interest rate decreases in the money market.

- In January 1985, some 5600 FCC borrowers who contracted an FCC loan between April 1, 1981 and December 1, 1982 at rates ranging from 14 to 16 3/4 per cent were allowed to have their loan rate converted to 12 3/4 per cent for a 5-year term. This represents foregone revenues of $16 million per year for five years to the government.

- The Small Business Bond (SBB) program was reintroduced in the federal budget in May 1985. Qualifying farmers in financial difficulty can roll existing SBBs coming due before December 31, 1987 into new bonds.

- The Ontario government has announced a targetted $50 million emergency assistance program called the Ontario Family Farm Interest Rate Reduction Program (OFFIRR) which will grant up to $14,000 to eligible farmers to cover interest costs over 8 per cent on existing long-term loans. OFFIRR will not help farmers with assets in excess of $500,000 and family enterprises that are not viable. Payments were to be made in the fall of 1985.

- In March 1985, the Manitoba Agricultural Credit Corporation wrote down interest rates retroactively to 8 per cent on all outstanding loans and set new loan rates at 9 3/4 per cent.

- The government of Saskatchewan has made available a cash advance program to all farmers of the province. The program consists of a one-year interest free loan of $125 per head of cattle payable upon the sale of the animal. If the animal is not sold after the year, the loan will carry a 11 3/4 per cent interest charge.

- Under the April revision of Saskatchewan's Counselling and Assistance Program, loan rates were reduced to one half of a percent above the prime rate.

- From January 1985 to December 1987, the Agricultural Development Corporation of Alberta is administering the Farm Development Guarantee Program by which eligible borrowers will get operating loans at the prime rate. However, the program is limited to maintaining the lines of credit previously given by private financial institutions.

3.2.2 Loan Guarantee Programs

To date, some $79 million have been allocated to the western drought region by both levels of government.

- The federal government is helping farmers in drought areas of Saskatchewan and Alberta by providing $48 million for the transportation of feed to the drought region.

- The Farm Improvement Loan Act has been extended from July 1, 1985 to December 30, 1986, providing an option that meets the intermediate-term financing needs of farmers. The interest rates attached to the loans matches the prime rates of each lending institution plus 1 per cent. This rate is a consequence of the basic guarantee offered by the Act. The terms are 15 years for loans to cover the purchase of additional land and 10 years for all other purposes.

- The revision of the Counselling and Assistance Program of the Farm Loan Improvement Act includes a provision for guarantees on loans for some debt consolidations and a provision for a second operating loan guarantee.

- The government of Saskatchewan has initiated a targetted grant program to maintain the provincial breeding herd during the difficult times caused by drought. Producers in the severe drought area are given $60 per head of breeding stock and those in the moderate drought area are given $30 per head.

- Because of the drought, the government of Saskatchewan has modified the crop insurance program to carry out the 100 per cent coverage to the year following the years when claims were made.

- In Saskatchewan, up to $16 per head of breeding stock to a maximum of $1600 per applicant is provided for trucking cattle out of the drought areas to northern pasture lands to send the cattle up north and the same amount is provided to bring them back south.

- The government of Alberta is expected to follow the initiatives of the government of Saskatchewan by the end of August or early September 1985.

- The Farm Development Guarantee Program administered by the Agricultural Development Corporation of Alberta (ADC) is offering loan guarantees as well as interest rates below market rates.

- In November 1984, the Ontario Farm Adjustment Program was extended for one additional year, thus extending the provision for operating loans to the end of 1987.

- Complementing the Ontario Farm Adjustment Program (OFAP) is the New Operating Loan Assistance Program similar to the provisions of the OFAP. In addition, a new Farm Operating Cash Assistance Program will be implemented in early June 1985 and it will be retroactive to January 1985 for those farmers who contracted a loan under the Ontario Farm Adjustment

Program. This three-year program providing a loan guarantee will thus enable farmers to get cash at 9 3/4 per cent.

3.2.3 Other Programs

- In February 1986, the federal agriculture minister announced the Canadian Rural Transition Program which will offer job counselling and retraining, as well as interim financial help to farmers whose operations are not viable.

- In April 1984, the FCC started to offer mortgage loans with terms of 5, 10 or 20 years, compared to the single 10-year term available previously.

- As of December 10, 1984, FCC appeal commissions including active farmers can be involved as a third party in the analysis of loans under recovery actions.

- Federal funding of $47 million has been allocated to reduce fertilizer costs in Alberta between August 1984 and July 1986.

- The Western Grain Stabilization Act was amended in February 1985 to provide farmers with an interim partial payment on or before the crop. A levy of 1.5 per cent of the product cash

value is paid to participating farmers to ease their cash flow situation.

- The federal fuel tax rebate announced in the fall of 1984 is estimated to save Canadian farmers nearly $100 million annually in operating costs. In February 1986, this measure has been extended to January 1, 1988.

- The Saskatchewan Farm Land Security Act provides an extendable moratorium on farm foreclosures and recoveries until December 31, 1985.

- The Farm Development Guarantee Program in Alberta provides financial counselling.

3.2.4 Comment

All these measures provide short-term relief for farmers experiencing marginal cash flow difficulties or caught by the tightening of commercial credit policies. However, most of these measures do not address the problem with sufficient effectiveness. Interest rate subsidies and loan guarantees are of no help for farmers with inadequate income and heavy debt repayment obligations. In addition, interest rate subsidies, concessional interest rates, and moratorium on farm foreclosures and

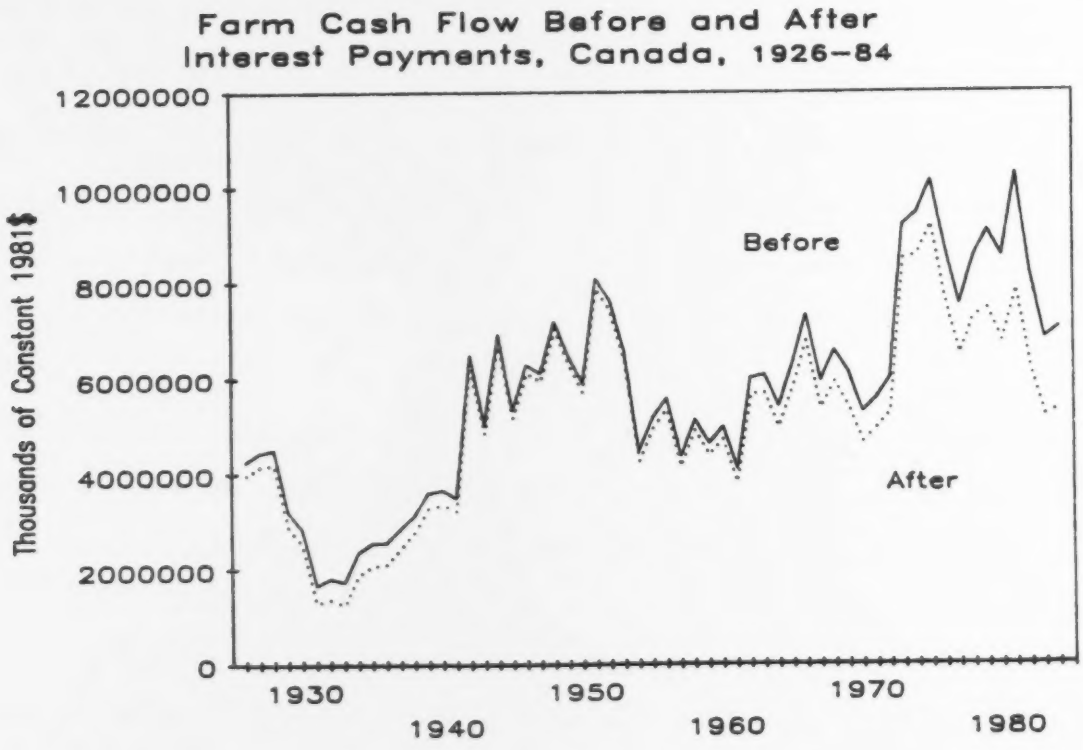
bankruptcies may have long run distorting effects on the agricultural credit market.

What is needed is a variable payment mechanism built into the credit instrument.[9] This type of instrument would be particularly valuable in times of rationed government resources. If the financial means or credit instruments in the 1970s had recognized the variability in agricultural product prices, the quantity of funds lent to agricultural firms would have had less dramatic consequences. For those farms which are technically bankrupt, however, the only type of solution may be financial restructuring.

Probably only a small proportion of farms in the 20 to 50 per cent equity range can benefit from interest rate reduction programs. Farms with sufficient cash flow will not need this assurance and those with too small a cash flow will still be unable to stop the deterioration of their financial position. The programs should therefore focus on a relatively small number of potentially benefiting producers. Since the FCC survey data do not include farm expenses, the expenses incurred in the production process must be hypothesized and the result would depend on these arbitrary imputed costs.

However, in aggregate, real farm cash flow (Figure 19) gives some indication on the extent of the decline experienced since

Figure 19


Farm Cash Flow Before and After
Interest Payments, Canada, 1926–84
Thousands of Constant 1981$
12000000
10000000
8000000
6000000
4000000
2000000
0
Before
After
1930
1940
1950
1960
1970
1980

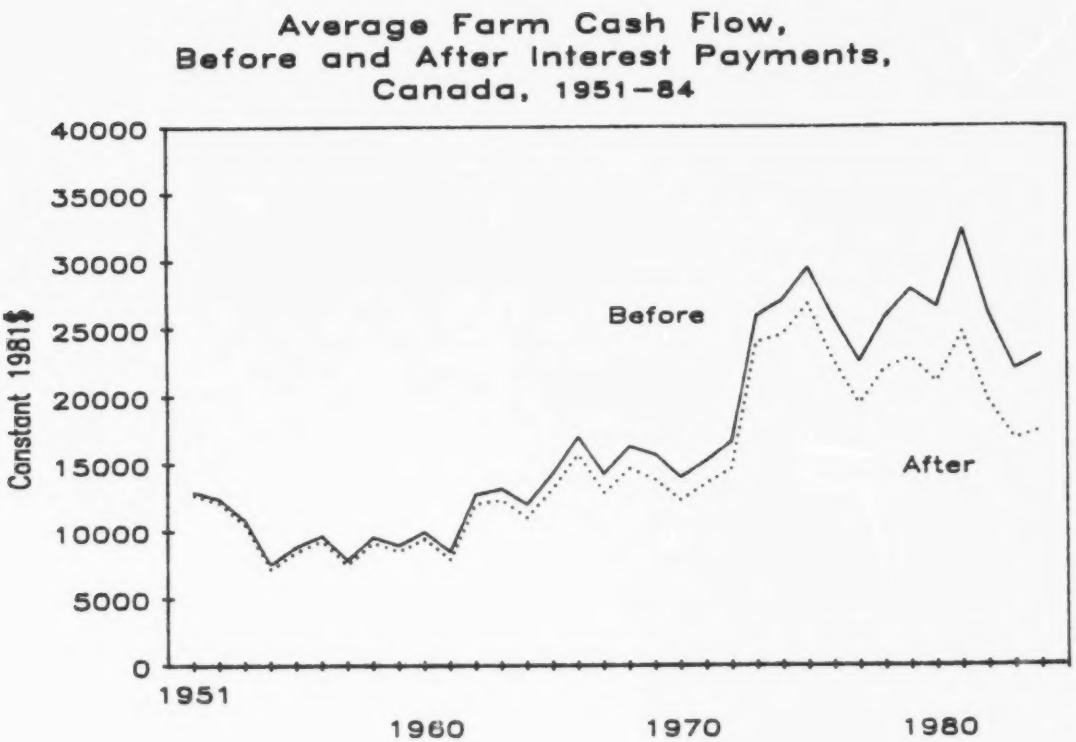
1981.[10] Since 1975, when real farm cash flow reached its all time peak, it has dropped significantly twice. The second fall started in 1981, reaching its lowest point in a decade in 1984. However, by 1984 real farm cash flows before interest payments were well above the averages for the 1950s and 1960s. Cash flows after interest were still above those of the 1950s in real terms, but just at the level preceding the surge of the early 1970s.

This provides some information on the cash flow experience of some groups of producers. It is clear that by 1984, conservative farmers with little or no debt experienced a better cash flow situation than before the price increases of the early 1970s. The real cash flow situation of farmers with interest payments close to the sectoral average is not worse than the one experienced 15 years ago. In fact, they are definitely in a better position than the same group back in the 1950s.

It is evident from this that although farmers who are heavily in debt have experienced a relatively difficult situation, the average net farm cash flow position (Figure 20) is still better than before the 1970s. The reduction in the number of farms appears to be offsetting the impact of increased interest costs which are accounted for in the net farm income figures.

For the cattle industry, one of the agricultural sub-industries most dependent upon competition, "direct assistance programs

Figure 20


Average Farm Cash Flow,
Before and After Interest Payments,
Canada, 1951–84
Constant 1981$
40000
35000
30000
25000
20000
15000
10000
5000
0
Before
After
1951
1960
1970
1980

especially of a direct commodity support nature" should be avoided. These programs would "prompt instant retaliation" [Canadian Cattlemen's Association, 1983] from our most important trade partner. Writing down debt, invoking debt moratoria or subsidizing interest rates would prolong the adjustment occurring in the industry. However, some government interventions could ease these adjustments. For example, as proposed in the Bruce County study (Deloitte, Haskins and Sells, 1985), a solution for these farmers may be the financial restructuration of their business along with a shift to other types of production.

4 WHAT ELSE COULD BE DONE?

The agricultural sector already benefits from a large array of programs and measures that support income, reduce volatility problems, and provide credit with better terms than available under market conditions.

In the previous sections, we have identified to some extent the segment of the industry that experiences a particularly difficult financial situation. Although, for all farmers the situation stems from the conjunction of high interest rates and low commodity prices, some farms have a poor financial situation that also reflects the decline in asset values. From this, we can define three groups of struggling farms:

1. The farms unable to generate the cash flow required to meet contractual financial obligations.
2. The farms with mismanaged resources.
3. The farms with negative net worth.

Farmers in the first category are unable to meet their debt repayment schedule mainly because of depressed commodity prices, while the enterprises they manage and operate still have some equity left after the last two years of declines in asset values. For these farmers, the solution is quite clear: they have to restructure their business to increase its liquidity. To do so, part or all of the remaining unliquid equity could be sold temporarily (to the FCC, for example) until either interest rates come down sufficiently, prices move up, or a better financial instrument is instituted. The financial restructuring of farm businesses with cash flow problems is a short-term solution.

The problem of stress in the cash flow can be attributed to two main causes: the attitude of farmers towards debt and the rigidity of the current debt instruments. The Economic Council, in Intervention and Efficiency (1982) proposed a solution to reduce rigidities in loan instruments. The attitude problem would have to be dealt with on two fronts: changing the attitude of farmers themselves and promoting equity financing in Canadian agriculture. Market forces will probably dictate more conservative attitudes but the promotion of equity financing would

require the introduction of some legislation, particularly concerning minimum land care obligations and rights of tenants in relation to the stability of the family farm concept cherished by the Canadian agricultural community.

In the second category, farms with mismanaged resources, probably the consequence of lack of investment in human capital before starting up the business with borrowed funds. Some agencies (OCA, FCC) assume that at least half of all financially struggling producers fit into this category. For most small businesses in Canada, such a degree of mismanagement would lead to exit from the industry. Why should it be different in agriculture? The exit of bad managers would leave more room for better equipped farmers to enter. Given the increasing importance of management abilities in farming, one could restate a proposal by W. J. Anderson in 1963: "A stronger extension program in technical farm management and production economies must be developed to assist individual farmers to adjust to sound business management programs." This statement is even more true today, as management abilities have become increasingly important inputs of production.

The third category, farms with negative net worth, are those of operators who entered the industry or expanded immediately prior to the decline in asset values. By the end of the 1970s, some analysts already predicted excess supply of farm products and a

fall in land prices to reflect lower anticipated rents (e.g., Gardner and Pope, 1978).

The highly debt-financed investments made in the late 1970s were risky investments. Other means of entrance or expansion existed (for example, rent agreements) and could have minimized the risk. As a consequence, these farmers may have to assume the risk they took at that time, as any other investor would have had to do. There is no reason why society should be responsible for private risk taking behaviors when the information is available to evaluate the nature of the risk. It would be difficult to justify additional government intervention on the ground of equity to help those caught by the consequences of untimely investments.

The attitude of farmers towards risk is something out of the realm of public policies, unless social disruption due to farm failures is large enough to justify educational programs or law-enforced guidelines.

5 CONCLUSION

The financial situation of a limited number of farmers, seems to be dramatic. About 3 per cent of Canadian farms are likely to see their small (7 per cent average) equity vanish over the next two years as asset values move closer to farm production values and no

significant improvement is expected in commodity prices. Asset values are also expected to respond to the very high real cost of debt and the oversupply of land that follows the recent restructuring of some farm businesses.

From the analysis presented in this paper, it is clear that the profitability of farming is still good (Figures 1, 7 and 13). The overall agricultural sector is not in a bad financial shape, only some farmers are. The problem is one of an excessive debt burden for a few farmers following untimely and unwise investment decisions. In terms of cash flow, the real aggregate and average situations are better than before the boom of the 1970s, even after interest charges are paid (Figures 19 and 20). Again, it is only those enterprises caught with too heavy debt a burden that are facing potential bankruptcy. It would be difficult to justify the provision of additional public funds to prevent this. The government would not only risk creating distortions in land and financial markets, but would also be criticized for extending special assistance to farmers when other private businesses and households did not receive such help during the last recession. Furthermore, slowing the exit of farmers with excessive debt might well elongate the recovery process of asset values, which would prevent the sector from becoming more responsive to market signals.

There is no sign yet that a major financial failure in agriculture is imminent. Farm cash flow after interest improved by 10 per cent in 1985, but it could come back to its 1984 level by 1987 due to the likely conjunction of current dollar deterioration in gross income, stability in operating expenses and a larger farm debt outstanding. In addition, the profitability of farming (defined as the income from assets and management) increased sharply in 1985 and it is expected to stay above the 1983 level for the next two years.

The financial analysis of the sector does not capture all aspects of the internal resources that can be used to help family farms survive. For example, according to tax-filers data, off-farm income represents some 80 per cent of total income of individuals reporting gross farm income. It remained relatively stable in the early 1980s. It increased by only 5 per cent between 1980 and 1983 partly because of the stagnation of farm income.

While the possibility of large scale defaults on agricultural loans in the near future appears remote, some measures could be implemented to reduce this possibility even more, with no apparent backsliding impact on land values and credit markets. This would require the creation of a new institution - a land bank or a land broker - which could add to the complexity of financial institutions in the sector.

Besides the institution of a credit instrument adapted to agriculture, the financial restructuring of farm firms with cash flow problems appears to be a realistic solution to avoid sinking more public funds into this sector of the economy. On the other hand, the restructuring process could be done by urging the FCC to buy, on a temporary basis, some of the equity remaining to the financially squeezed farms. Other farmers with either mismanaged resources or negative net worth have shown that their entry or expansion was not done in a way that minimized the financial risk of their decision. Their decision to enter the industry can hardly be justified in terms of competence and timing. They may have to liquidate a portion of their assets or find their way out to let better equipped farmers enter. These may be the best ways to minimize the losses incurred by untimely and large debt-financed capital investments. In the long run, the promotion of equity financing could prevent similar problems from occurring and could ease the transfer of farms to new owners over time.

APPENDIX A

A Note on Methodology

Most of the financial data presented in the figures of this report are derived using a method inspired by Melichar (1984). Most data series are constructed from Statistics Canada data. However, the following assumptions were necessary to obtain proxies for unpublished series.

1. The income imputed to operators' and unpaid family labour is assumed to be the product of the hourly wage rate (including room and board) of paid workers and the number of person/hours worked by operators and unpaid family workers.

2. The aggregate income imputed to operators' management work is assumed to be indistinguishable from the income return from assets. This assumption is based on the dominant Canadian farm ownership pattern, the absence of a market for farm managers (or a too imperfect market), and the fact that, historically, farm management duties were very limited because of the lower value of assets and the smaller size of farms in the past.

3. Capital gains from assets were obtained using the annual change in the value of farm capital net of the capital formation and the investments in livestock. Real capital gains (Table 2)

were derived by adjusting the gains to reflect the change in the purchasing power of all the funds tied in the farm assets.

4. Similarly, capital gains are made on debt (Figure 4). This is because funds owed lose some purchasing power.

APPENDIX B

Regional Differences

The methodology we used to derive the financial indicators for the whole Canadian agricultural sector was also applied for some provinces. Because of data limitations, we could not derive the financial indicators for the Atlantic provinces.

The financial indicators for Quebec, Ontario, Manitoba, Saskatchewan, Alberta and British Columbia (Table B.1) show that the rates of return on assets and equity were generally in line with the Canadian indicators.

During the 1970s, national rates of return on farm assets and equity averaged 7.3 and 9.3 per cent, respectively, after adjusting for the loss of purchasing power of all the funds tied up in the assets. During the period 1980-84, these ratios averaged -2.2 and -3.1 per cent, respectively. The provincial situations in all provinces except Saskatchewan were similar to these national averages. In Saskatchewan, the average rates of return from assets and equity were still positive in the 1980-84 period, reflecting smaller rates of capital losses than in any other provinces.

In the early 1980s, the average profit margin deteriorated significantly in Manitoba (-10.1 per cent) and Saskatchewan

(-5.5 per cent) and increased in Ontario and Alberta. The profit margin is an indicator of the income that can be used to pay interest charges. On average in Canada, 15 per cent of gross farm income is left to be distributed among operators and lenders.

The analysis of the farm cash flow positions in the six provinces for which sufficient data were available is extremely important. The provincial data reveal that the interest charges do not reduce the farm cash flow to the same extent in each province.

Both before and after interest charges are discounted, the average provincial cash flow positions are all significantly above the pre-boom level with the exception of Saskatchewan and Manitoba, where the annual average cash flow position after interest in the 1980s is about at the same level as it was in the 1960s. However, given the reduction in the number of farms, the average cash flow per farm is likely to be well above that in the 1960s in all provinces, especially in Quebec, Ontario, Alberta and British Columbia.

While interest charges had an increasing dampening effect on the average cash flow position in central Canada, Alberta and British Columbia, they had minimal impacts on the farm cash flow position in Saskatchewan and Manitoba. This is probably the consequence of the location of most rental agreements. Nevertheless, this draws attention to a more fundamental difference in the source of the

problems faced by farmers today. This difference is of major importance for policy in targetting their potential assistance. Since interest charges do not reduce the farm cash flow as much in Saskatchewan and Manitoba, as they do in all other provinces (Figures B.1 to B.6), the reduction in the farm cash flow in these two provinces during the 1980s is related less to the burden of the farm debt than to income. Therefore, the recommendations made in Western Transition (Economic Council of Canada, 1984) are likely to be more effective in providing a solution to the problems faced by farmers in Saskatchewan and Manitoba than would the indexed mortgage recommendation of Intervention and Efficiency (Economic Council of Canada, 1982).

Table B1

Regional Farm Financial Indicators, 1970-79 and 1980-84

Averages	Qué.	Ont.	Man.	Sask.	Alta.	B.C.	Canada
				(Percent)			
Rate of Current Return on Assets and Management							
1970-79	5.0	2.5	4.1	5.1	1.0	3.0	3.2
1980-84	3.8	2.7	1.4	2.4	1.6	2.1	2.3
Real Rate of Capital Gains (Losses) from Assets							
1970-79	2.0	3.7	3.0	3.5	5.6	5.3	3.4
1980-84	(4.5)	(6.7)	(5.9)	(1.5)	(4.8)	(4.2)	(4.4)
Total Rate of Return on Assets							
1970-79	7.0	6.2	7.1	8.6	6.6	8.2	7.3
1980-84	-0.6	-4.0	-4.5	0.9	-3.3	-2.2	-2.2
Rate of Return on Equity							
1970-79	9.2	7.3	8.6	10.2	7.6	10.3	9.3
1980-84	-1.5	-5.5	-5.8	0.6	-4.0	-3.1	-3.1
Profit Margin							
1970-79	14.4	12.5	17.1	23.1	6.3	19.9	15.5
1980-84	13.1	15.3	7.0	17.6	14.3	18.0	14.8

Figure B.1

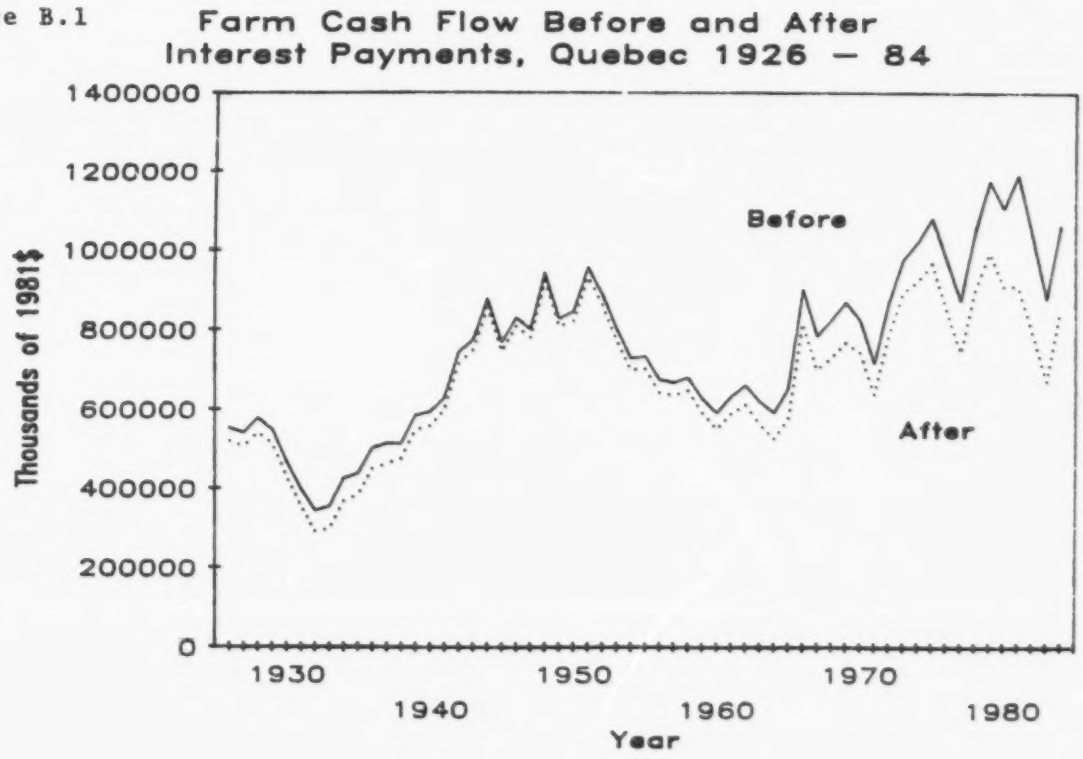


Figure B.2

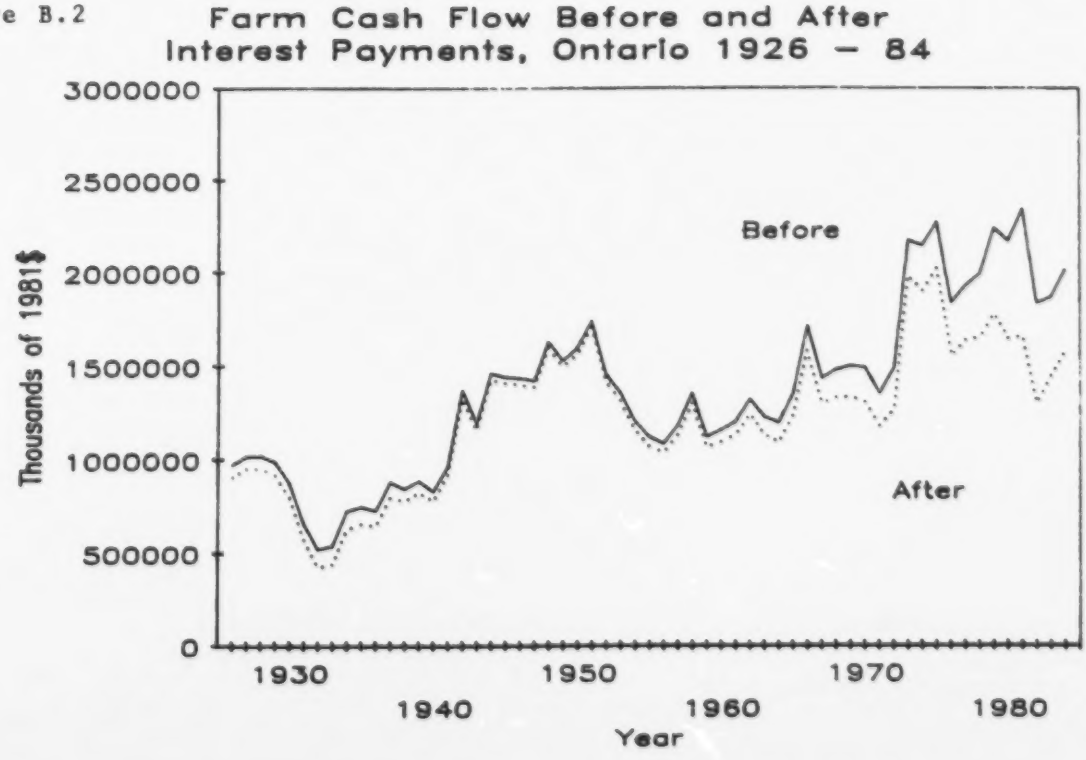


Figure B.3

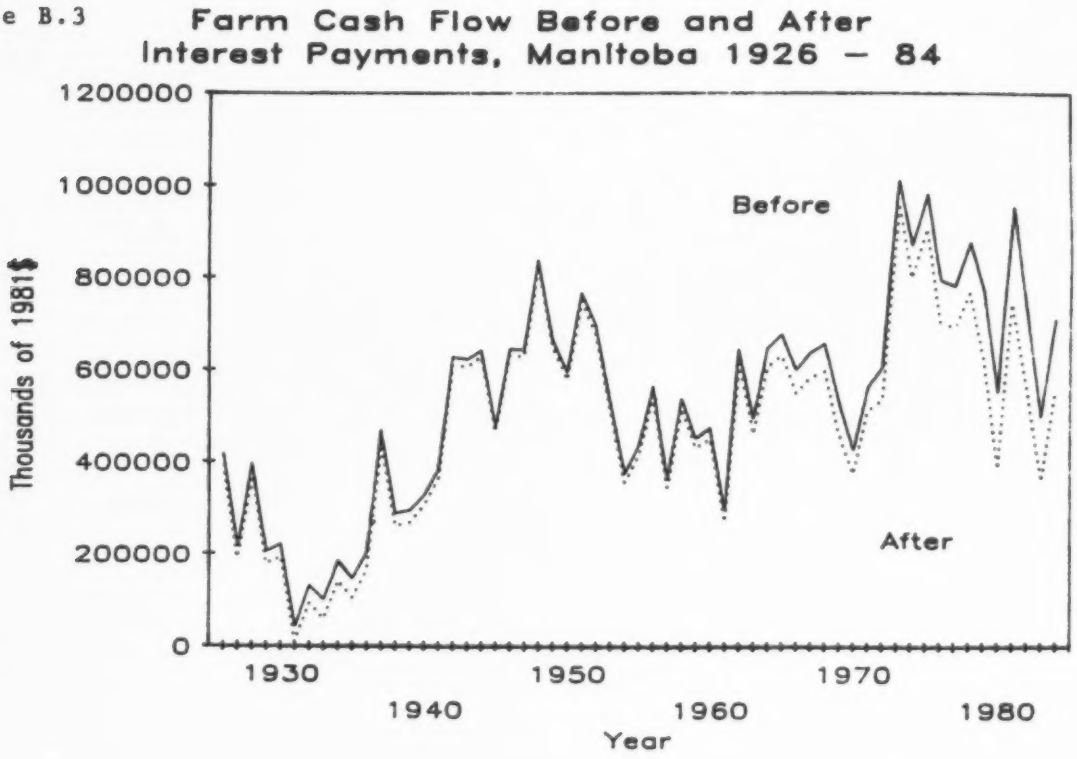


Figure B.4

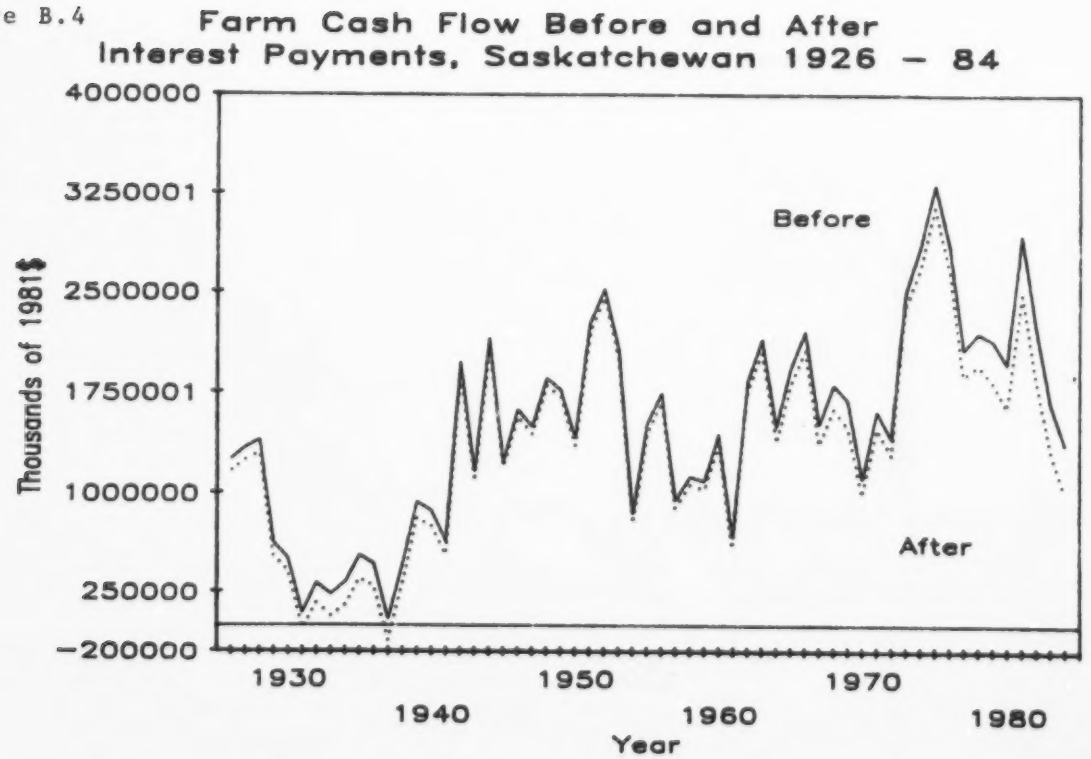


Figure B.5

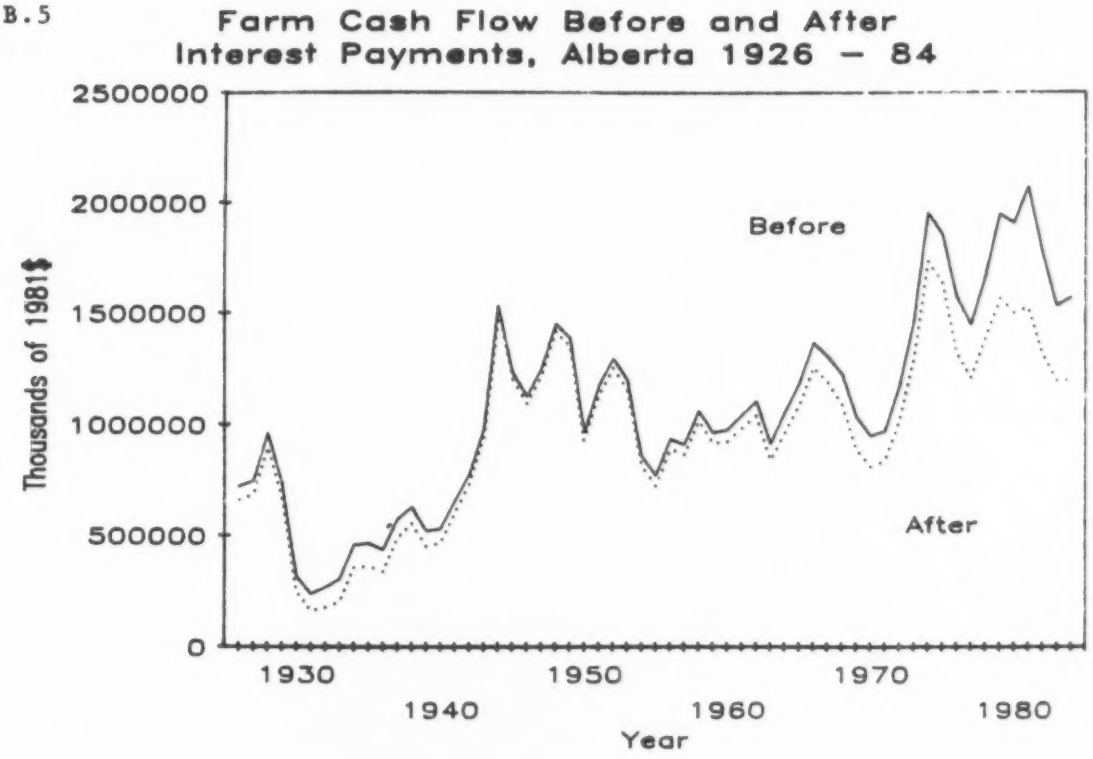
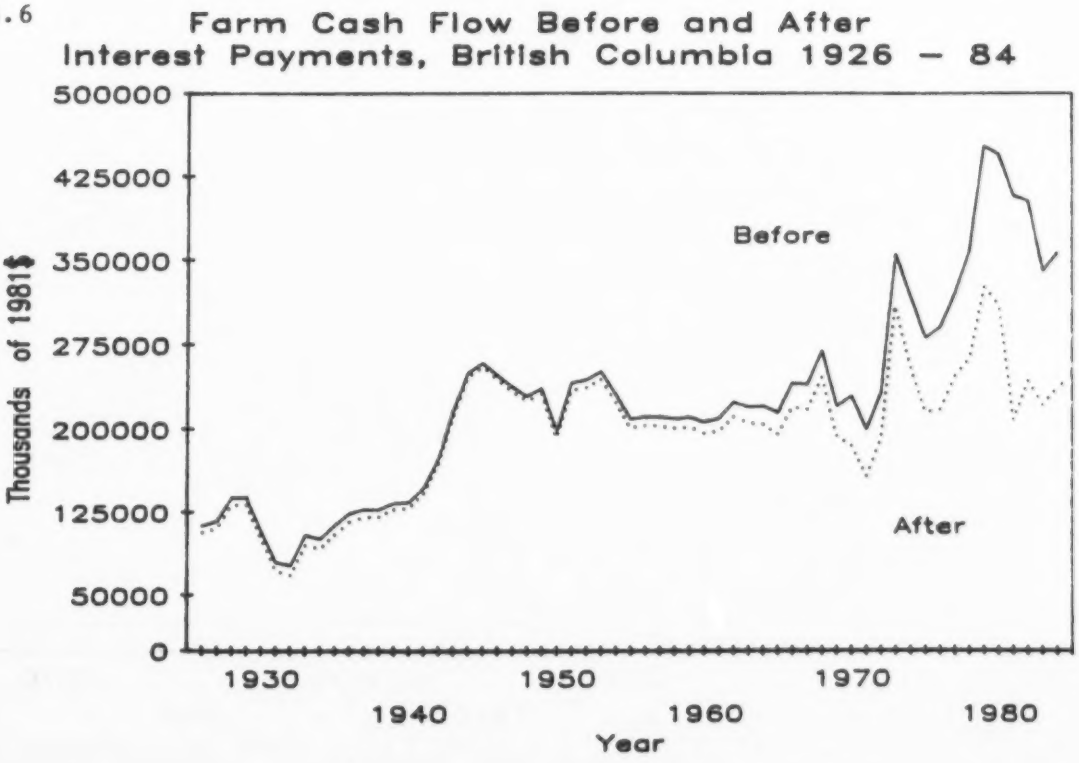


Figure B.6



APPENDIX C

RECOMMENDATIONS BY TWO STUDY GROUPS

Various Solutions Proposed by the Task Force on Agricultural Finance

In November 1984, the Task Force on Agricultural Finance identified four priorities that should lead to targetted solutions to short- and long-term problems related to agricultural finance. Although credit was the major concern, non-credit measures were also proposed as possible solutions to alleviate cash flow problems.

The identified priorities were: strengthening the capital structure of the farm sector; improving the cash flow situation of farmers; protecting against interest rate volatility; and improving rates of return on capital through complementary measures with respect to market and production.

The Task Force proposed a number of federal government initiatives to improve the effectiveness of existing programs, to provide reasonably priced credit and improved access to credit, and to provide stability of interest costs in the agricultural sector. Some of these mechanisms have already been implemented and are listed in the section on special measures in this report.

Other interesting proposals which have not yet implemented are the following:

1. To promote the introduction and/or more widespread private sector offering of financial instruments suited to the needs of agriculture in the 1980s and beyond. Examples of proposed instruments are:

   a) long-term fixed rates interest loans;

   b) accrued interest rate mortgages (much like the indexed mortgage recommendation of Intervention and Efficiency);

   c) shared appreciation mortgages;

   d) fixed rate operating credit; and

   e) future and options markets.

   This proposal was supported by the Ontario Federation of Agriculture.

2. To provide guarantees for privately financed farm mortgages. This would expand the amount of mortgage credit available from private individuals, with more favourable terms and conditions than those currently offered by commercial and public lenders. This proposal reflects views expressed in most of the briefs submitted to the Task Force. The major advantage of this proposal may be the attempt to retain capital in the farm sector. The disadvantages are mainly that it does not provide assistance to farmers who have the greatest need for improvement in the cash flow position of their business and that it increases the contingent liabilities of the government.

3. To improve cash advance programs to provide a uniform treatment of cash advances across all commodities.

4. In response to a widespread request for more operating loan subsidies, in particular from the Ontario Federation of Agriculture, the National Farmers Union and the Canadian Cattlemen's Association, the Task Force proposed providing operating loan guarantees to farmers in financial difficulties.

In summary, two approaches are proposed to improve farmers' capacity to meet planned cash flow commitments with volatile income and interest rates:

1. To build some degree of flexibility into farm debt instruments.
2. To increase the flow of equity capital in the industry.

Recommendations of the Bruce County Agricultural Study

The Bruce County Agricultural Study was conducted by the consulting firm of Deloitte, Haskins and Sells Associates. The firm was employed by the County of Bruce in response to the terms of reference issued by the County Provincial Study Committee in October 1984. Their purpose was to conduct an in-depth analysis of the agricultural economy of Bruce County, located in the Bruce Peninsula in the extreme southwestern part of Ontario. Given the

predominance of beef cattle farming in this area, many farmers and industry representatives have strongly associated the Bruce County farm problems with the red meat sector, in particular beef.

To meet their terms of reference, the consultants conducted a series of nine group interviews with farm couples across the county and approximately 50 in-depth individual interviews with farmers and agricultural industry representatives, as well as a review of relevant agriculture and industry statistics.

The Bruce County interviews found that many farmers wanted long-term debt contracts in conjunction with reasonable rates. From these findings, Deloitte, Haskins and Sells recommended that a long-term mortgage credit program be instituted with fixed interest rates no higher than 10 per cent and terms of not less than 20 years. In addition, the study recommended that operating and intermediate loans be tied to the expected life of the asset.

It is worth mentioning that the FCC is already offering mortgages with 20-year terms, while the request for the fixation of interest rates might be compatible with the 1982 Indexed Mortgage proposal of the Economic Council of Canada.

Responding to the excess capacity in the beef sector, Deloitte, Haskins and Sells recommended that new crop opportunities be demonstrated on-farm. This would have the advantage of speeding the transfer of agricultural resources to more profitable uses.

Deloitte, Haskins and Sells also proposed the implementation of a tripartite stabilization program for red meats, as requested by the Canadian Cattlemen's Association. Such a program would involve the participation of producers, provincial and federal governments, and would imply that the provinces agree to phase out any provincial price or income stabilization scheme that would give commodity producers an artificial financial advantage not enjoyed by other Canadian producers, or that would be an incentive to over-produce. Even if such a program does not receive the unanimous consent of all provinces, the federal government has already amended the Agricultural Stabilization Act to allow for such a tripartite program (House of Commons of Canada, June 1985). Ontario and the Prairie provinces have opposed the amendment that appears to allow for supplementary provincial stabilization payments.

Notes

1. For the periods 1966-71, 1971-76 and 1976-81, gross entry rates were 24.1 per cent, 30.3 per cent, and 25.3 per cent, respectively. On the other hand, gross exit rates were 35.4 per cent, 35.6 per cent and 29.7 per cent, respectively. Some studies of entry and exit rates show that (see Kapitany and Bollman):
   1) The flows are higher for operators with more off-farm income.
   2) Off-farm income would tend to reduce the net outward migration of farmers.
   3) Part-time farming is more important as a facilitator of entry into full-time farming than a facilitator of exit.
   4) The availability of non-farm jobs has a positive influence on the rate of entry.
   5) The decision of entrants to work off the farm would reflect the opportunity cost rather than financial obligation.
   6) Entry in agriculture is positively correlated with the education of the operator.
   7) The industry is losing farmers most quickly at the highest and lowest levels of education.
   8) One-third of exists can be attributed to retirement.

2. The capital gains and losses calculation does not take into account some short-term, intermediate and long-term farm assets such as cash, bonds, savings, account receivable, feed and supplies, quotas and non-farm real estate owned. According to the 1984 FCC Farm Survey, these farm assets contributed more than $16 billion to total 1984 farm assets. In addition, some of these assets generate an income that is not accounted for in the income from asset figures we have derived.

3. Further evidence of recent farm debt restructuring comes from Agriculture Canada data which show that in 1983 alone, long-term farm credit extensions increased to 21 per cent with decreases in short- and intermediate-term extensions.

4. Farm RFBs were very few before 1975. This is because the FCC had a much more conservative lending policy. The agency was lending a maximum of 75 per cent of asset value while often the evaluation of assets was written down, for the purpose of lending only, to 75 per cent of the value. As a result, the maximum amount lended was around 50 per cent of asset values. Today, the FCC is lending up to 100 per cent of asset values.

5. Bankruptcy numbers can be misleading because they could be inflated by personal bankruptcies with enterprises which are still somewhat viable, as experienced in Quebec recently. Because of a growing number of partnerships, the occurrence of this phenomenon is likely to increase artificially the slope

of the trend in farm bankruptcies. Between 1975-76 and 1984-85, the proportion of group borrowers at the OCAQ increased steadily from 6.7 per cent to 34.6 per cent of all long-term loans. However, according to Consumers and Corporate Affairs Canada, it is not possible to get the proportion of personal bankruptcies among farm bankruptcies.

6. Data source: 1984 FCC Survey Data.

7. Miscellaneous specialty farms include greenhouses, nurseries, mushroom houses, sheep, horses, apiaries, fur farms and goats.

8. It has been recognized that lending practices of some financial institutions moved from security lending to lending on the basis of repayment capacity. This can be understood as being the result of decreasing asset values started in the early 1980s (see Task Force on Agricultural Finance, 1984, p. 4).

9. On this subject, see Economic Council of Canada, 1982, pp. 101-3. The federal budget of February 1986 brought a measure similar to the Council's recommendation. However, the budget measure has other characteristics that could distort financial markets (see pp. 33-39).

10. The methodology to obtain these results is an adaptation of the one used by Melichar (1984) for the U.S.

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